Due service of the within Brief is hereby acknowledged this.....day of October, A. D. 1938.

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Counsel for Petitioners.

SUPREME COURT
OF THE
United States

October Term, 1938
No. 21

WILLIAM B. RANSOME, *et al.*,

Petitioners,

vs.

SAMUEL L. CARSTENS, Jr., Insurance Commissioner of the State of California, *et al.*,

Respondents.

On Writ of Certiorari to the Supreme Court of the State of California.

Brief of Respondents, Carroll C. Day, Harry C. Fabling, Joseph M. Gantz, Jack Paschall and Ralph J. Wetzel.

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STATUTES.

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Opinions Below:

Carpenter v. The Pacific Mutual Life Insurance Company of California, 10 Cal. (2d) 307, 74 P. (2d) 761 [R. 1509-1544].

Although not a part of the record, the oral opinion of the Superior Court of Los Angeles County (the trial court) was transcribed and printed. [R. 1469 *et seq.*]

Jurisdictional Authority:

Judicial Code, Sec. 237(b), as amended by Act of February 13, 1925, Ch. 229, 43 Stat. 936; U. S. C., Title 28, Sec. 344 (b).

Statutes Involved:

Insurance Code of the State of California (1935), Secs. 1010 to 1061 (Ch. 145 as amended by Ch. 291: Stats. 1935, p. 500, at pp. 540-553);

U. S. Constitution, Art. I, Sec. 10;

Sec. 1 of Fourteenth Amendment to U. S. Constitution.

(Pertinent sections of Insurance Code will be found in the appendix hereto.)

Date of Judgment, etc.:

The order in the trial court was made and given December 4, 1936, and was entered December 7, 1936 [R. 1378-1444].

The judgment of affirmance by the state Supreme Court was made and given December 7, 1937. [R. 1509.] A rehearing was denied January 6, 1938. [R. 1545.]

Petition for certiorari was filed April 2, 1938, and granted May 16, 1938 (304 U. S. .....; 58 S. Ct. 1039 [R. 1546]).

Nature of the Case, Rulings, etc.:

On July 22, 1936, respondent, The Pacific Mutual Life Insurance Company of California, was insolvent within the meaning of the Insurance Code and its business was then in a hazardous condition. Upon the application of the Commissioner an order was made by a judge later discovered to be disqualified, appointing the Commissioner conservator. Thereupon he took possession of the assets of said corporation. On the same day on successive applications the same judge appointed the Commissioner liquidator of said corporation and approved a plan of rehabilitation authorizing a sale of substantially all of the assets of said corporation to a new company formed by the Commissioner for that purpose. Shortly thereafter it was discovered that the said orders were void because of the disqualification of the trial judge. Thereupon the Commissioner was appointed conservator *de novo* by a qualified judge and continued to carry on the business of the Old Company through his corporate instrumentality, the New Company. Some weeks later after extended conferences, held at the instance of the trial court, at which numerous parties and their attorneys were present, the Commissioner submitted a revised plan which, after a six-weeks trial, was on December 4, 1936, approved by a qualified judge who ratified and approved all of the Commissioners's acts and authorized the execution and full performance of the revised "Rehabilitation and Reinsurance Agreement" [R. 1396-1444].

Of the numerous policyholders and other persons interested who had appeared at the trial only *four* policyholders (petitioners herein) appealed to the Supreme Court of California which, on December 7, 1937, affirmed the order of the trial court of December 4, 1936, and held, among other things, that there was no violation of the California Constitution or laws and that the "due process," the "equal protection" and "contract" clauses of the federal Constitution had not been violated.

IN THE

SUPREME COURT

OF THE

UNITED STATES.

October Term, 1938.
No. 21.

WILLIAM H. NEBLETT, *et al.*,

Petitioners,

vs.

SAMUEL L. CARPENTER, JR., Insurance Commissioner of the State of California, *et al.*,

Respondents.

Brief of Respondents, Carroll C. Day, Harry C. Fabling, Joseph M. Gantz, Jack Paschall and Ralph J. Wetzel.

PREFATORY STATEMENT.

[Italics are ours.]

This cause is brought before the court on certiorari to the Supreme Court of California to review the judgment of that court [R. 1509-1544] affirming an order of the Superior Court of Los Angeles County made December 4, 1936 [R. 1378 *et seq.*]. The order approved a plan and agreement [R. 1396 *et seq.*] of Samuel L. Carpenter, Jr., Insurance Commissioner of the State of California, con-

servator of respondent, The Pacific Mutual Life Insurance Company of California, for the rehabilitation and reinsurance of the business of that company.

We are not satisfied with petitioners' statement of facts. It is colored by their legal theories and conclusions of law. We propose to give our own statement of facts as briefly as the complicated factual and procedural situation permits. Before giving this statement, we wish to direct the court's attention to certain rules of California law applicable to a consideration of the facts.

Petitioners appealed to the state Supreme Court on the judgment roll alone. None of the evidence was before the state Supreme Court and none is contained in the record before this court. The trial court made many recitals in the order appealed from but did not make formal findings of fact, none being required [R. 1531, 1532]. The order of December 4, 1936, made by the Superior Court, is tantamount to a general verdict in favor of the Commissioner. In such a situation all facts alleged by the Commissioner in his pleadings and in pleadings filed by other parties in support of the Commissioner's position, which tend to support the order appealed from, and are not negatived thereby must be presumed conclusively to have been proved by competent evidence and to be true. On the other hand any objections, statements of opinions, conclusions or allegations made by any of the parties herein, or other objectors, which if true or well founded would tend to militate against the correctness of the order appealed from, must be presumed conclusively not

to be sustained by the evidence—in fact it is conclusively presumed that they have been negated by competent evidence.

Gray v. Gray, 185 Cal. 598, 599;

Pavilion Ice Rink v. O'Brien, 60 Cal. App. 185, 186;

Pacific Investment Co. v. Ross, 131 Cal. 8, 10;

Antonelle v. City Hall Comm'rs, 92 Cal. 228, 229;

Shindelar v. Hadacheck, 88 Cal. App. 319, 320;

Cummings v. Howard, 63 Cal. 503, 504.

Moreover, where, as in this case, the appeal is taken on the judgment roll alone and no evidence is adduced, the findings or recitals of the trial court will be construed so as to support rather than overthrow the judgment or order, and it will be presumed that competent evidence was introduced in support of all such findings. Every presumption must be indulged in support of the order.

Keeling Collection Agency v. McKeever, 209 Cal. 625, 628;

Anglo California Trust Co. v. Oakland Railway, 193 Cal. 451, 461.

The state Supreme Court in its opinion adopted and followed the rules above announced [R. 1528, 1539].

Accordingly, in giving our statement of facts and the references to the record, we rely not only on the recitals of the various orders made by the Superior Court, but also on the allegations contained in the various pleadings filed by the Commissioner and by respondents in the Superior Court who aligned themselves with the Commissioner.

STATEMENT OF FACTS.

Prior to the time its business was taken over by the Insurance Commissioner, respondent, The Pacific Mutual Life Insurance Company of California (the Old Company), had been engaged for a period of sixty-eight years in the State of California, and elsewhere throughout the United States, in the business of issuing and selling life insurance [R. 820]. During the last fifty years it had also been engaged in the business of issuing and selling contracts and policies of health and accident insurance [R. 820]. In August, 1918, the Old Company began issuing and selling non-cancellable contracts and policies of health and accident insurance (in the record and herein called non-can policies) [R. 820].

Until recent years the business prospered, so that as of December 31, 1935, the Old Company was doing business in more than forty states [R. 847]; had assets in excess of $200,000,000 and life insurance in force in excess of $600,000,000 [R. 846], insuring the lives of approximately 200,000 persons [R. 6]. In addition it had outstanding about 75,000 policies of health and accident insurance [R. 6], of which approximately 49,000 (so stated by Mr. Neblett in his oral argument below (p. 8) and believed to be correct) were non-can policies. Approximately two-thirds of the life business was written on a participating basis, and the remainder on a non-participating basis [R. 846]. The life insurance business was very profitable and had built up adequate assets behind its reserves in a very substantial amount [R. 846]. Its *commercial* accident and health business had earned a net annual profit in recent years of several hundred thousand dollars [R. 847].

In the course of its operations the Old Company built up an extensive agency organization which operated throughout more than forty of the various states [R. 847]. This agency organization had been built up over the entire period of existence of the Old Company at an expense of several million dollars [R. 847]. By reason of the great volume of its business and the extent and nature of its operation, the Old Company had acquired a good will which was recognized throughout the entire United States [R. 847]. This good will, agency organization, and going concern values were and are of very great value, to-wit, several million dollars [R. 1386], and a group of objecting non-can policyholders alleged that $10,000,000 was a conservative figure to be placed upon said goodwill [R. 1148].

The non-cancellable health and accident policies, which as we have said, the Old Company commenced to issue in the year 1918, were based on an inadequate premium rate [R. 847], resulting from actuarial under-calculations [R. 847], and, as later experience developed, the premiums were found to be insufficient to pay the losses incurred thereon [R. 847-848]. In subsequent years the premium rates on the non-can policies were increased, but further experience disclosed that even at such increased rates the premiums were not sufficient to maintain the reserves necessary to mature the policy obligations [R. 848].

In 1936 the California Insurance Commissioner, in conjunction with the insurance commissioners of several other states, commenced a convention examination of the affairs of the Old Company as of December 31, 1935 [R. 3]. The report and examination was dated July 21, 1936 [R. 12], and was filed in the office of the Insurance Commissioner [R. 11]. It showed on its face that the

Old Company, as of December 31, 1935, had a surplus in the participating department of $4,792,118.97, and a deficit as of the same date in the non-participating department, including all accident and health business, of $22,356,493.67, so that the liabilities exceeded the assets for the combined departments by the sum of $17,564,374.70 [R. 30-31]. The deficit in the non-participating department was wholly caused by the condition of the accident department (which would include the non-can policies), in which the deficit was $23,025,470.70 [R. 30]. The report concluded with the following statement:

> "From a survey of the above figures, it is apparent that immediate action must be taken to protect policyholders." [R. 32.]

The condition was such that when said report of convention examination was filed with the Insurance Commissioners, or similar authorities of the various states within which the Old Company was authorized to transact business, its authority would be suspended or cancelled in most, if not all, of said states [R. 849]. This was particularly serious in that more than sixty per cent of the Old Company's business was conducted in states other than California [R. 848].

On July 22, 1936, the Commissioner filed an application in the Superior Court of Los Angeles County for an order appointing him conservator of the Old Company and vesting title to its assets in him [R. 1-32]. The application purported to be filed under Section 1011 of the Insurance Code [R. 10]. A certified copy of said report was annexed [R. 12-32] and incorporated by ref-

erence [R. 3]. The Commissioner alleged that said examination and report

> "Shows that respondent corporation is in such condition that its further transaction of business will be hazardous to its policyholders, its creditors and to the public; that said examination and report further shows that respondent corporation is insolvent within the meaning of Article 13, Chapter 1, Part 2, Division 1, of the Insurance Code of the state of California * * *." [R. 3.]

The Old Company appeared and consented to the relief prayed for by the Commissioner in his said application [R. 33].

Thereupon the Superior Court (Honorable Douglas L. Edmonds, presiding) made its order granting the relief prayed for [R. 34-38], and the Commissioner took possession of the business and assets of the Old Company [R. 39].

The Commissioner then filed his application for an order to liquidate the Old Company and for his appointment as liquidator [R. 39-47]. The Old Company consenting thereto [R. 48], the court (per Edmonds, J.) made an order of liquidation, appointing the Commissioner liquidator[1] [R. 49-52].

The Commissioner thereupon filed a petition for an order permitting, approving and authorizing the rehabili-

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[1]It must be presumed that this order appointing the Commissioner liquidator was vacated, for the order appealed from refers to the Commissioner as conservator "* * * or if he should hereafter be appointed liquidator" [R. 1389].

tation, sale and transfer of assets and reinsurance plan and agreement of the Old Company [R. 53-60]. Annexed to the petition as Exhibit "A" was the plan of rehabilitation [R. 63-102]. This application was purported to be filed under the provisions of Section 1043 of the Insurance Code [R. 62].

On the same day Judge Edmonds made his order approving the plan and authorizing the execution of the agreement and the transfer of the assets [R. 103-107]. The plan so approved[2] need not be noticed in detail as it was entirely superseded by a revised plan approved on December 4, 1936, and affirmed by the state Supreme Court, such judgment of affirmance being now presented to this court for review. Suffice it to say that the plan provided for the organization by the Commissioner of a new company to be known as "Pacific Mutual Life Insurance Company" (hereinafter and in the proceedings called the New Company); for the purchase of all its capital stock for $3,000,000 ($1,000,000 capital stock and $2,000,000 surplus), with funds of the Old Company, and for the transfer of substantially all of the assets of the Old Company to the New Company. The New Company was immediately organized, the capital stock purchased, and the Commissioner executed the agreement all on the same day that the foregoing orders were made, to wit, July 22, 1936 [R. 152 and 182]. On the same date the Commissioner executed a deed and

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[2]On the following day, July 23, 1936, upon the Commissioner's petition [R. 108-141], Judge Edmonds made an order approving an amendment to said agreement [R. 142, 143], and the amended agreement was thereupon executed [R. 146; R. 193-225].

bill of sale to the New Company [R. 183-190]. The Old Company joined in this deed and bill of sale [R. 190].

On July 23, 1936, the New Company filed a petition for intervention and for an order directed to all interested parties to show cause why the court should not make an order confirming, approving and ratifying the permission theretofore given with respect to said plan and agreement, and confirming and approving the execution of said amended plan and the transfer of the assets by deed and bill of sale [R. 144-151]. On the same date, July 23, 1936, Judge Edmonds made an order permitting intervention and directing interested parties to show cause on August 12, 1936, as prayed for in the petition of the New Company [R. 226-232].

It should here be noted that the foregoing orders—three made on July 22, 1936, and two made on July 23, 1936—are the only orders appearing in the record made by Judge Edmonds.

Beginning on August 6, 1936, interested parties, officers, stockholders and policyholders of the Old Company, filed various pleadings, variously denominated complaints in intervention or responses to said order to show cause [R. 233-321].

Petitioner Neblett, on August 10, 1936, filed a complaint in intervention [R. 245-251], in which he alleged he was the owner of a policy issued by the Old Company. He sought to set aside all of the orders theretofore made in this proceeding upon the ground *(inter alia)* that said orders were in conflict with Section 1 of the 14th amendment to the federal constitution. His complaint in intervention did not allege what kind of a policy he owned, but the order of December 4th referred to him

as the holder of a life policy [R. 1380], and in his notice of appeal he referred to himself as the holder of a life policy [R. 1459].

Shortly before August 11, 1936, it was learned that Judge Edmonds was the owner and holder of a life policy issued by the Old Company. Fearing that Judge Edmonds was thereby disqualified, and that some, if not all, of his orders might be called in question, the Commissioner, on August 11, 1936, again presented to the court his application for his appointment as conservator of the Old Company, and for the vesting of its assets in him as such conservator. The application was heard *de novo* by another judge of said Superior Court, the Honorable Henry M. Willis, who thereupon made an order [R. 322-328]: (1) ratifying, approving and confirming the order appointing conservator, made by Judge Edmonds, and adopting said order [R. 325]; (2) *appointing Insurance Commissioner, Samuel L. Carpenter, Jr., conservator of the Old Company* [R. 325]; (3) vesting title to the assets of the Old Company in the Commissioner [R. 326]; (4) enjoining the further transaction of business by the Old Company [R. 326]; (5) enjoining any interference with the management and transfer of the assets, and enjoining any attachment or levy without the consent of court [R. 327]; (6) requiring the officers, directors, agents, servants and employees of the Old Company to deliver to the Commissioner all books, records and other assets belonging to the Old Company [R. 327]; (7) directing the Commissioner to formulate, work out and prepare a plan of rehabilitation or reinsurance agreement, which should be subject to the approval of the court [R. 327-328]; and (8) decreeing that the order did not constitute any revocation or abrogation of any of the orders made by Judge Edmonds, or any

ruling or adjudication as to the effect of the ownership of the policy by Judge Edmonds on his right to sit in the proceedings [R. 328].

Beginning on August 12, 1936, numerous other policyholders filed complaints in intervention or answers to the order to show cause of July 23, 1936 [R. 329-464].

On August 13, 1936, the Commissioner filed an application before Judge Willis for an order to liquidate the Old Company [R. 465-474].[3] The next day he filed a petition[4] with respect to rehabilitation, sale and transfer of assets, and reinsurance plan and agreement [R. 484], resubmitting the plan of July 22, 1936 [R. 497-537].

Other policyholders filed complaints in intervention or answers to the order of July 23rd to show cause. On August 19, 1936, petitioner Alfred F. MacDonald filed such a return [R. 626-630], in which he alleged he was the owner of a non-can policy issued by the Old Company which was in full force and effect. He objected to the plan on the ground, among others, that it was in violation of his rights under certain sections of the state constitution and also Section 1 of the 14th amendment to the Constitution of the United States. He also objected to any plan or scheme which would impair the obligation of his policy. On the following day, August 20th, petitioners Bettin and Dickinson filed their return to said order to show cause [R. 681-687], in which they alleged they were each the owner of a non-can policy issued by the Old Company. They objected to the original plan on grounds identical with those urged by petitioner MacDonald.

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[3]It must be presumed that this application was never acted on [R. 1389].

[4]This petition was presumably abandoned [R. 1522].

The Commissioner and the New Company filed answers to certain complaints in intervention theretofore filed, among which was the answer to the complaint in intervention of petitioner Neblett [R. 548-550].

Policyholders and other persons interested continued to file complaints in intervention and responses to the orders to show cause of July 23rd and of August 13 and 14, 1936, made by Judge Willis, objecting to the Commissioner's plan.[5] The Pacific Mutual Agency Association filed a complaint in intervention [R. 819-827], supporting the Commissioner's plan except that it prayed for modification and amendment of paragraph 14 of the agreement between the Commissioner and the New Company [R. 826-827].

On August 17, 1936, Judge Willis on the application of the Commissioner made an order[5] authorizing and directing the Commissioner and the New Company to continue to perform acts required of or permitted to be performed by them under the original rehabilitation agreement [R. 851].

August 29, 1936, Judge Willis gave his order ratifying and confirming the intervention of the New Company and ratifying and confirming the order to show cause made July 23, 1936 [R. 829-830].

On September 25, 1936 [R. 904], the Commissioner filed his third petition for approval of a rehabilitation and

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[5]The orders to show cause of August 13th and 14th, and the order of August 17th are not contained in the transcript.

reinsurance agreement [R. 846-904]. The agreement itself was annexed to the petition as Exhibit A [R. 858-904]. This plan, which we will refer to as the approved or revised plan, differed in certain respects from the plan submitted with his petition of July 22nd and again with his petition of August 14th.

The petition alleged the corporate existence of the Old Company, its authority to do an insurance business prior to July 22, 1936, the amount, character and history of its business, and that the *life insurance* business was profitable [R. 846-847]. It was further alleged that the so-called "non-cancellable income disability policies" were issued at an entirely inadequate premium rate [R. 847-848], and that a formal examination had been made showing a deficiency in excess of $23,000,000.00 in the reserves necessary to mature the non-can policies. The Commissioner asserted that the filing of this report would result in a suspension or cancellation of the Old Company's right to do business in most, if not all, of the states [R. 848-849].

A recital was given of certain of the procedural steps theretofore taken and the measures the Commissioner had undertaken in organizing the New Company, "Pacific Mutual Life Insurance Company," and the transfer of certain assets of the Old Company to the New Company [R. 850]. The Commissioner alleged that he had given diligent study and attention to the problem of determining what steps would best serve the interests of all persons concerned, had made diligent inquiry among possible insurers, had invited the presentation of plans or offers, and had carefully examined and considered all plans suggested. He alleged that in his opinion no plan of rehabilitation or

offer of reinsurance had been presented which afforded to the policyholders of the Old Company the protection provided in the proposed rehabilitation and reinsurance agreement annexed to the petition as Exhibit A. He accordingly submitted the agreement and asked for the approval thereof [R. 851-852].

In his prayer he asked for an order fixing the time and manner of notice of hearing [R. 853], and directing all persons interested to show cause why an order should not be made [R. 853]; ratifying his various acts, including the conveyance theretofore made to the New Company [R. 853, 856, 856-857]; ratifying and approving the proposed agreement, Exhibit A, and directing him to execute such agreement [R. 853]; authorizing the performance of the terms of said agreement to be by him performed [R. 854]; directing the determination of federal taxes, giving them priority, and saving the rights of the United States [R. 854-856], and reserving jurisdiction in the court [R. 856].

Briefly, the revised plan (or agreement) provided for the sale of all the assets of the Old Company to the New Company excepting the stock of the New Company and the rights of action against the officers, directors and employees of the Old Company, including rights upon their fidelity bonds. The plan was optional as to all policyholders. Dissenters were given the right to file claims with the Commissioner thereafter to be appointed liquidator. The New Company reinsured and assumed all policies except policies held by active holders of non-can policies (*i. e.*, non-can policyholders who had not suffered disability on or before July 22, 1936). It also assumed one hundred per cent liabilities on matured policies, including obligations to disabled non-can policyholders (*i. e.*,

holders of non-can policies who on or before July 22, 1936, had become disabled). It assumed a fractional liability on the unmatured non-can policies of from 20% for those issued in 1918 to as high as 90% for those issued in 1935. Premiums were payable at the original rates fixed in the non-can policies. All the net profits of its business, except the participating department, and 10% of the net profits from assumed participating policies were to be paid ratably (a) to a special fund to be used for restoring to the future disabled holders of non-can policies who had consented to the plan full benefits retroactively according to the face of their policies, with interest at three and one-half per cent per annum, and (b) to the Commissioner as liquidator on account of claims filed by dissenters. The New Company agreed to pay to the Commissioner, as liquidator of the Old Company, the reserves behind each policy held by a dissenter and also a pro rata share of said net profits until the sums so paid to the liquidator were sufficient to pay all claims in full.

The revised plan of rehabilitation was dated as of July 22, 1936 [R. 1396], and the effective date was stated to be July 22, 1936, at the hour of 1:00 o'clock, P. M. [R. 1398.] The plan and agreement further provided that when approved by the court it should

> "constitute an independent agreement, superseding all prior agreements; and also an amendment of the agreement of July 22, 1936, relating to reinsurance by the New Company of the business of the Old Company, in such manner that such agreement, as amended, shall read in its entirety in the language of this agreement." [R. 1443.]

This plan was formulated following extended series of conferences conducted at the instance of the trial court, at which conferences representatives of holders of all forms of life and accident insurance policies issued by the old corporation, and representatives of its stockholders, general agents and creditors [R. 1272] took part. The Commissioner gave diligent study and attention to the problem of determining what steps would best serve the interests of all persons concerned [R. 851-852]. He made diligent inquiry among possible reinsurers or purchasers for the purpose of determining what avenues were open [R. 852]. He invited the presentation of plans or offers and carefully examined and considered all plans and suggestions submitted to him for the rehabilitation of the Old Company or for the reinsurance of its business in whole or in part [R. 852].

September 25, 1936, the court made its order to show cause in accordance with the prayer of the Commissioner's petition, fixed a time and place of hearing, and directed that notice of the hearing be given as follows: by posting; by publishing for ten consecutive days in five Los Angeles papers, two San Francisco papers and one Sacramento paper; by mailing a copy of the order and agreement to the Insurance Commissioner or equivalent official of each state in which the Old Company did business on July 22, 1936; by mailing to each policyholder and stockholder a notice of the time, place and purpose of the hearing, in a form specified in the order to show cause;

and by serving a copy of said order to show cause in the manner and in accordance with the provisions of Sections 1005 and 1010-1013a, both inclusive, of the Code of Civil Procedure, upon all persons who had personally made an appearance in the proceeding or upon their attorneys of record [R. 910-913].

On October 6, 1936, petitioners Bettin and Dickinson filed a return [R. 990-995] to the order to show cause dated September 25, 1936, in which they again alleged that each was the owner of a non-can policy issued by the Old Company, upon which all premiums had been paid and each of which policies was in full force and effect. They objected to the matters set forth in the order to show cause upon various grounds, among which were the following: that the proposed plan of rehabilitation was not the best possible plan; that the plan would render practically worthless policies owned by the objectors; that the plan undertook to substitute fractional liability by the New Company for the obligations of the Old Company to said objectors, and that the plan, if carried out, would constitute a violation of the objectors' rights under certain sections of the State Constitution and Section 1 of the Fourteenth Amendment to the Constitution of the United States [R. 992-993]. They also objected to any plan which would impair their non-can policies in any manner of way [R. 993].

Petitioner Alfred F. MacDonald, on October 19, 1936, filed his return [R. 1233-1236] to the order to show cause of September 25, 1936. In this return he again alleged the ownership of a non-can policy in full force and effect, and he made substantially the same objections and upon substantially the same grounds as those made in the return of petitioners Bettin and Dickinson.

Respondents Day, Fabling, Gantz, Paschall and Wetzel, in whose behalf this brief is being filed, on October 19, 1936, filed a return [R. 1258, *et seq.*] to the order to show cause dated September 25, 1936, in support of the Commissioner's revised plan. From this return it appeared that all of said respondents were and had been for many years general agents of the Old Company [R. 1259-1265]; that four of them were holders of life policies as well as non-can policies issued by the Old Company [R. 1266-1269], and that they owned in the aggregate more than 6,000 shares of its capital stock. [R. 1270.] It was alleged that they intervened in the proceedings before the Superior Court on their own behalf and on behalf of all the general agents and managers of the Old Company [R. 1258], who with their sub-agents owned in excess of 22,000 shares of the stock of the Old Company, were the holders of 2,227 life policies in the total aggregate of $10,163,326.00, and were also holders of 430 non-cancellable income policies which provided for a total indemnity of $64,665.00 per month [R. 1270-1271].

Appellant Neblett, on October 19, 1936, filed his objections [R. 1274-1276] to the revised plan of rehabilitation, in which he objected to all of the matters set forth in the order to show cause, upon the ground, among others, that the orders prayed for by the Commissioner would be void for the reason that the same would be a denial of due process of law guaranteed by the Fifth and Fourteenth Amendments to the Federal Constitution, and for the further reason[6] that the Insurance Code was repugnant both to the State Constitution, and to the Federal

[6]Mr. Neblett waived this reason on oral argument before the State Supreme Court [R. 1532].

Constitution, to-wit: the Fifth and Fourteenth Amendments thereof.

Many others filed returns to the order to show cause dated July 25, 1936, opposing said revised plan [R. 1075 *et seq.*]. E. A. Conway, Secretary of State and *ex officio* Insurance Commissioner of Louisiana, filed a return approving and supporting the plan [R. 1002 *et seq.*]. Certain interested parties, including petitioner Neblett, filed plans of their own [R. 1056 *et seq.* Hess; R. 1172 *et seq.*, 1319 *et seq.*, 1351 *et seq.*, the so-called Giannini plans and revision thereof; R. 1347 *et seq.* Neblett].

On October 8, 1936, the court (per Willis J.) made an order [R. 997-1001] *nunc pro tunc* amending certain recitals of the order appointing conservator made July 22nd by Judge Edmonds [R. 34 *et seq.*], and the order of similar effect made by Judge Willis on August 11, 1936 [R. 322 *et seq.*].

Beginning October 19, 1936, a hearing was had lasting approximately six weeks [R. 1378] during which evidence, both oral and documentary, was introduced and every opportunity afforded to all interested persons to be heard [R. 1383]. By the time the trial was commenced the pleadings were such that the stockholders, the general agents and every class of policyholder were before the court under the doctrine of class representation [R. 688, 1258, 766, 914 and 948. See, also R. 1379-1382]. It will be noted, however, that none of the petitioners filed any pleadings under the theory of class representation or for anyone other than himself [R. 245, 1274, 1347 (Neblett); 626 and 1233 (MacDonald); 681 and 990 (Bettin and Dickinson)].

On December 4, 1936 [R. 1395], the court (Judge Willis presiding) made the order appealed from [R. 1378-1444] approving the Commissioner's revised rehabilitation and reinsurance agreement [R. 858-904] which was annexed to said order as Exhibit "A" [R. 1396-1443].

The court, after reciting the appearances, the fact that evidence, oral and documentary, had been introduced, and full opportunity afforded to all persons to be heard, and that the court had read and considered its order of August 17, 1936, and the original agreement submitted by the Commissioner on July 23, 1936, ordered, adjudged and decreed that reasonable, just and sufficient notice had been given to all persons interested [R. 1384], and that an adequate opportunity to be heard had been given to policyholders, creditors, stockholders and other persons interested [R. 1384-1385]; that the Exhibit A annexed to the order was the plan proposed by the Commissioner, was recommended by him and was approved by the court [R. 1384]; that adequate provision was made by said agreement for each and every class of persons interested; that neither the plan nor the agreement discriminated unfairly or illegally in favor of any class; that the agreement and plan fairly and equitably protected and adjusted the rights, obligations and liabilities of all persons concerned, and provided for the removal of the causes which made the proceedings necessary [R. 1385].

The court then made an adjudication, the effect of which was to determine that the company was technically insolvent on December 31, 1935 and on July 23, 1936, within the meaning of the Insurance Code, and that on July 22, 1936, further transaction of its business would be hazardous to its policyholders and creditors and to

the public [R. 1385-1386]. The court adjudged that the assets of the Old Company would be of substantially less value if they were sold separately than if sold as a going concern, and that the Old Company had intangible assets, consisting of good will, agency organization and going concern value, of the value of several million dollars, which the plan would preserve and conserve [R. 1386]. The court further adjudged that the plan was feasible and operations thereunder were feasible [R. 1386]; that the plan and agreement were fair, just and equitable [R. 1387]; that the plan and agreement afforded a feasible method with in a reasonable time of fully restoring the benefits under the non-can policies partially assumed by the New Company [R. 1387], and that all the policyholders and creditors of the Old Company had been given and were afforded by said agreement a fair, just and timely opportunity to participate in the benefits thereof and in the plan therein embodied [R. 1387]. The various acts of the Commissioner, including the conveyance theretofore made to the New Company, were ratified and approved [R. 1387-1388]. In addition, the Commissioner was authorized to perform the terms of the agreement [R. 1388], and to transfer *de novo* to the New Company all of the assets of the Old Company, excepting the capital stock of the New Company and claims against the officers, etc., of the Old Company and upon their bonds [R. 1388-1390]. The Commissioner was authorized to perform future acts either as conservator or as liquidator, if he should thereafter be appointed liquidator, as contemplated by said agreement [R. 1389]. The court reserved jurisdiction [R. 1390], preserved the preferred rights of the United States [R. 1390-1391]; authorized the Commissioner and the New Company to

do all things necessary, desirable or proper to carry out the terms of the agreement [R. 1391-1392], and directed the officers of the Old Company to assist in the consummation and effectuation of said agreement [R. 1392-1393]. The court directed that the New Company be let into possession of the assets conveyed to it free and clear of any charge of the Old Company or any of its policyholders, creditors or stockholders, except such rights as were conferred under or grew out of the rehabilitation agreement [R. 1393-1394]. All persons were barred from making any complaint in respect to said agreement except as therein permitted or by an appeal, and all suits were barred [R. 1394-1395]. Finally, the acts of the Commissioner done pursuant to the orders of August 11, 1936, and August 17, 1936,[7] were ratified and approved [R. 1395].

Of the numerous policyholders, stockholders and other persons interested in the proceedings, the four petitioners alone appealed to the Supreme Court of California for themselves only and not in behalf of any other of the persons interested [R. 1451 (Neblett); R. 1462 (Bettin and Dickinson); R. 2 in L. A. No. 16222 (MacDonald)]. Petitioners took their appeal on the judgment roll alone, so that no evidence was before the state Supreme Court [R. 1526, 1529].

In support of an affirmance of the order from which the appeal was taken the attorneys for the Commissioner were joined by William M. Rains, Esq. (10 Cal. (2d) 313), attorney for the respondents Edwin Janss, *et al.*, a committee representing commercial policyholders, non-

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[7]This order does not appear in the record.

can policyholders and life policyholders [R. 1382]; by Henry S. Dottenheim, Esq. (10 Cal. (2d) 313), attorney for certain respondents, holders of non-can policies and for all non-can policyholders not otherwise represented [R. 948]; and by the authors of this brief (10 Cal. (2d) 313), in behalf of respondents Carroll C. Day, *et al.*, whose interests have already been specified:

Subsequent to the making of the order of December 4, 1936, and prior to January 7, 1937, the Commissioner as conservator of the Old Company, executed the rehabilitation and reinsurance agreement and executed a new deed and bill of sale in favor of the New Company [Supp. R. fol. 101].[8] On January 7, 1937, the Commissioner filed in the Superior Court of Los Angeles County his application for an order to liquidate and for his appointment as liquidator of the Old Company [Supp. R. fols. 1-10]. On February 2, 1937, the Superior Court of Los Angeles County made an order for liquidation of the Old Company and appointed Samuel L. Carpenter, Jr., liquidator

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[8]At the time this brief is being printed the suggestion of respondents Day *et al.* of a diminution of the record and their motion for certiorari submitted on October 3, 1938, is still pending and undetermined. Limited time has forced us to prepare this brief as if said motion had been granted and the Supplement to Transcript of Record mentioned therein were before the court. Except as otherwise stated, references to said "Supplement to Transcript of Record" are to the folios (*i. e.*, the pages as originally printed and filed in the Supreme Court of California) of Mr. Neblett's Transcript on Appeal in L. A. No. 16221.

thereof [Supp. R. fols. 99, *et seq.*]. Acting under the authority of Section 1019 of the Insurance Code, the court fixed the rights and liabilities of the Old Company, its creditors, policyholders, shareholders and all other interested persons as of July 22 1936 [Supp. R. fol. 103]. Petitioners herein took appeals to the Supreme Court of the State of California from the order of February 2, 1937 [Supp. R. fols. 107, 3 (of L. A. 16245) and 3 (of L. A. 16246)], which appeals are now pending and undetermined, submission having been vacated pending the decision of this court herein. (Minutes May 19, 1938, 92 Cal. Dec. page ii, following p. 462.)

December 7, 1937, the state Supreme Court affirmed the order approving the plan and agreement [R. 1509], holding in brief that Judge Edmonds was disqualified and that all his orders were void, but nevertheless, the Commissioner was authorized to, and did lawfully, enter into possession of the property on July 22, 1936, pursuant to the summary seizure provisions of Section 1013 of the Insurance Code; that the holding that Judge Edmonds' orders were void did not affect the validity of any of the subsequent proceedings, which stand by themselves independently of the prior orders [R. 1527]. The state Supreme Court held that the Commissioner's petition (or application) for his appointment as conservator contained proper allegations; that the transfer was not in fraud of creditors; and that the plan and the order appealed from did not violate any of the constitutional rights of the appellants, petitioners here. A rehearing was denied on January 6, 1938 [R. 1545].

Within due time (April 2, 1938) petitioners petitioned this court for writ of certiorari, which was granted May 16, 1938 (304 U. S. ....., 58 S. Ct. 1039).

THE ISSUES INVOLVED.

Upon the foregoing facts, petitioners urge seven grounds[9] why the judgment of the state Supreme Court should be reversed.

1. They contend that the Commissioner's application for his appointment as conservator of the Old Company was insufficient in substance; that the Superior Court never obtained jurisdiction over the subject matter of this special proceeding, and consequently the order of December 4, 1936, is void and for that reason they have been deprived of their property without due process of law.

2. They assert that Judge Willis confirmed Judge Edmonds' void orders, including those affecting title; that the state Supreme Court erroneously held that the void orders could be validated by subsequent approval, and that subsequent orders of a qualified judge confirming void orders of a disqualified judge deny them due process of law under the Federal Constitution.

3. They urge that the holding of the state Supreme Court, to the effect that the Commissioner could lawfully carry on the business of the Old Company while in conservatorship through the agency of a corporate instrumentality (the New Company), is void, because it is in direct violation of law and for that reason their property has been taken without due process of law.

The three points above stated are unique in this case and could not have been urged except for the fact that Judge Edmonds was disqualified and his orders void, and

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[9]We have in some instances grouped several of petitioners' related points as one ground.

except for the further fact that the Commissioner's application for appointment as conservator was in the particular form appearing in the record.

In addition to the foregoing points founded on procedural facts, petitioners urge four additional points, as follows:

4. They contend that the Old Company was in legal effect reorganized, and that this power to reorganize cannot be implied from the right of the Commissioner as conservator to enter into rehabilitation agreements (*i. e.*, the construction thus given to the Insurance Code was erroneous). They assert that the state Supreme Court, in holding to the contrary, erroneously relied on certain New York decisions.

5. Petitioners urge that the language of Section 1043 of the Insurance Code providing that the Commissioner, with the approval of court, "may enter into rehabilitation agreements," is so vague and indefinite as to be unconstitutional.

6. Petitioners argue that the order of December 4, 1936, is violative of their constitutional rights and that they were compelled to consent to the Commissioner's plan of rehabilitation or lose all their rights; that the only right given to nonconsenting policyholders is to file a claim with the liquidator, and that there never was any liquidator.

7. In their supplemental brief petitioners contend that Section 1011 of the Insurance Code is unconstitutional in

that (a) the Superior Court is required to vest title to the assets of an insurance company in the Commissioner upon his filing an application for appointment as conservator [Supp. Br., Point II, pp. 7-9], and (b) the Insurance Commissioner takes evidence and makes findings determining the forfeiture of title without notice and hearing [Supp. Br., Point III, pp. 10-16].

Of the seven contentions urged by petitioners we contend that the first four do not present federal questions.*

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*NOTE. In their supplemental brief [Point I, pp. 5-6] petitioners assert upon the authority of *Brinkerhoff-Faris Trust & Savings Bank v. Hill,* 281 U. S. 673, that all of their points raise federal questions. In the case cited the Supreme Court of Missouri denied petitioner any relief in equity, holding that it had an adequate remedy at law. However, by previous decisions the Missouri court had denied the existence of any such remedy and at the time of the decision there under review the time to exercise the remedy had lapsed. This court, while not denying to the state court the right to construe its own statutes, properly held that where such construction denied petitioner any hearing at all, there was a denial of due process. The case is not in point. The reasons why the contentions of petitioners, grouped above as points 1 to 4, inclusive, do not present federal questions will be given in our answer to these four propositions.

We also contend that the fifth point and the seventh point, while apparently raising federal questions, are not well taken in law and really present no questions of substantial merit. The sixth point, we concede, raises a federal constitutional question, but in this regard we contend that the state Supreme Court correctly decided that there was no impairment of the obligation of contract and no unlawful or unconstitutional discrimination.

We propose, nevertheless, to meet fully all seven contentions of the petitioners, without prejudice, however, in respect to the new points raised for the first time in the supplemental brief, to urge that these new points should not be considered by the court.

SUMMARY OF THE ARGUMENT.

1. The first point decided by any court, although it may not be in terms, is that the court has jurisdiction. The Superior Court decided that it had jurisdiction, and this question was therefore inherently involved in the appeal. The state Supreme Court by affirming the order decided that the Superior Court had jurisdiction. The state Supreme Court also expressly determined that the Commissioner's application for his appointment as conservator was sufficient under Section 1011 of the Insurance Code. This question is peculiarly a question of state law and cannot be converted into a federal question by the assertion that the Superior Court under California law did not have jurisdiction. The state Supreme Court, as a matter of state law, having decided that the Superior Court did have jurisdiction, and petitioners having appeared and having been heard, there is no ground for arguing that there has been any denial of due process of law because of lack of jurisdiction in the state courts. Moreover, on the merits, petitioners' contentions are not well taken. The said application was clearly sufficient. The Commissioner alleged two different statutory grounds for his appointment as conservator, each of which was properly set forth in the application.

2. The orders made by Judge Willis are valid and do not depend on void orders made by Judge Edmonds. Judge Willis could and did validly ratify the acts of the Commissioner, including his conveyance to the New Company on July 22, 1936. The Superior Court obtained jurisdiction upon the filing of the Commissioner's application for appointment as conservator and the appear-

ance of the Old Company. The fact that the application was called up before a judge disqualified to act thereon does not divest the court of jurisdiction, although the order of the judge is void because of his personal disqualification. Petitioners' contention that the state Supreme Court held that void orders of Judge Edmonds were validly ratified by Judge Willis is not supported by the record. The Supreme Court held that the order appealed from validated the acts of the Commissioner. This holding was on a matter of state law and does not raise a federal question. On the merits the opinion was correct. The order appealed from authorized the Commissioner to make a new conveyance to the New Company and such conveyance was actually made.

3. The asserted error of the state Supreme Court in holding that during the period of conservatorship the Commissioner could operate the business of the Old Company through his corporate instrumentality, the New Company, does not raise a federal question. Whether the Commissioner could so operate the business was peculiarly a question of state law and the decision of the state Supreme Court is conclusive here. Even if it be assumed that the Supreme Court of California in so holding was in error, that does not make its decision void or support a claim of lack of due process. Moreover, petitioners are not aggrieved thereby.

4. The asserted error of the state Supreme Court in *construing* the state Insurance Code so as to permit the rehabilitation of the business of an insolvent insurance company by means of a new company is peculiarly a question of state law and does not present a federal question. This court is bound by the decision of the state

Supreme Court in that regard. (Whether the plan of rehabilitation violates the constitutional rights of petitioners is an entirely different question which will be considered later.)

5. The language of Section 1043 of the Insurance Code of California, providing that the Commissioner as conservator or liquidator may subject to the approval of the court enter into rehabilitation agreements, is not vague or uncertain and the section is constitutional. Said section is a grant of power to be exercised by the Commissioner under the direction of the Superior Court subject to appeal to the state Supreme Court. The Commissioner is neither forbidden nor required to enter into such agreements. Neither he nor the other party to the agreement nor the persons interested in the insurance company being rehabilitated are required to act at their peril. The term "rehabilitation agreements" had been given a definite meaning before the Insurance Code was enacted in 1935 by the decisions of the New York state Courts made under a statute upon which the California Insurance Code is modeled.

6. The business of insurance is affected with a public interest. The business of insurance vitally affects the state and its citizens and the state may take reasonable methods to rehabilitate the business of an insolvent insurance company and avoid liquidation. It protects its own interest and the interest of the policyholders generally through the exercise of the police power.

7. The approved plan does not violate petitioners' rights under the Federal Constitution. Reinsurance with the New Company was optional with all policyholders. They were not compelled to take out reinsurance because of the fact that a liquidator had not been appointed by December 4, 1936. It will be presumed from the record, and the fact is that a liquidator was appointed shortly after December 4, 1936. Since the Old Company was insolvent the only right the policyholders had was to receive the equivalent of what they would have received upon complete liquidation. They had no vested right in any form of remedy, and could not insist on liquidation instead of rehabilitation. It is to be presumed from the record (which contains no evidence) that each dissenter from the plan will receive as much as or more than the amount he would receive on liquidation. If, however, it could be assumed that dissenters are placing some small portion of their share of the assets to the risk of the new business, no constitutional rights are impaired thereby. All this was done for the benefit of all the creditors. The Commissioner had the option to liquidate, but this would compel a forced sale of the assets and would destroy intangible assets of very great value to the detriment of all policyholders, consenters or dissenters. A ratable assumption of all policies would not only destroy the intangible assets but would inevitably lead to liquidation. The approved plan was not unjustly discriminatory to any class of creditors. The difference in treatment was necessary because it was the only

means of retaining the Old Company's business as a going business and of furnishing a fund from future profits, from which the holders of non-can policies who consent to the plan may eventually become fully restored and dissenters may receive not only the full amount of what they would have received on liquidation but even more, to wit, the full amount of their claims. The intangible assets consisting of goodwill, going concern value and agency organization were inherently a part of the profitable business, the obligations of which were completely assumed. A life insurance business differs from the ordinary business in that the customers are the creditors. Any plan which would not provide for the complete assumption of the obligations of the profitable business would destroy the going concern values and goodwill. Under the approved plan these intangible assets are conserved and inure to the benefit of holders of non-can policies who assent to the plan and to the dissenters. The principle of the approved plan was the only feasible method of avoiding liquidation, immediate or deferred, and of conserving the full amount of the intangible assets and the probability of the receipt of continued profits.

8. Apart from the benefits secured to the non-can policyholders and dissenters of all classes, the plan was entirely equitable. The decided cases show a pronounced trend toward the broad equitable principle that policyholders in each class have a preferred claim to the reserves behind their policies over the rights of the policy-

holders of any other class. The court should not hesitate to apply this principle to the situation in the case at bar.

9. Similar proceedings have been upheld in other jurisdictions and the application of the principles in the decided cases to the case at bar warrants an affirmance of the judgment of the state Supreme Court.

10. Petitioners' contentions, made for the first time in their supplemental brief, that Section 1011 of the Insurance Code is unconstitutional because (a) the Superior Court is required to vest title to the assets of an insurance company in the Commissioner upon his filing an application for appointment as conservator, and (b) because the Commissioner takes evidence and makes findings determining the forfeiture of title without notice and hearing, were not raised in the state proceedings nor in the petition for *certiorari*, neither were they assigned as error, nor mentioned in the brief in support of said petition. Under such circumstances the point should not be considered by this court. However, there is no merit to petitioners' contentions in that regard. The Commissioner acts purely in an administrative capacity, much as a bank examiner and the Comptroller of the Currency act under the national banking law. The appointment of a conservator under Section 1011 of the Insurance Code is subject to immediate revision and full hearing under Section 1012 of the Insurance Code. In any event, no one could raise this point except the Old Company, and it appeared and consented to the appointment of the Commissioner as conservator.

ARGUMENT.

I.

The State Supreme Court Decided That the Superior Court Had Jurisdiction and Expressly Determined That the Commissioner's Application for His Appointment as Conservator Was Sufficient in Substance to Vest the Trial Court With Jurisdiction. This Holding Is Binding on This Court for It Is Purely a Matter of State Law. In Any Event, the Petitioners' Contention Is Without Merit.

Petitioners assert that the Commissioner's application for his appointment as conservator of the Old Company is insufficient in substance; that therefore the Superior Court never obtained jurisdiction over the subject matter of this special proceeding; and that consequently the order of December 4, 1936, is void and for that reason they have been deprived of their property without due process of law. [Pet. pp. 33-38; reasserted without argument, Supp. Br. pp. 19 and 22.]

Petitioners are not asserting under this point any lack of due process in the usual sense of that term, and, indeed, they could not. They were given ample notice and opportunity to appear and be heard. The requirements of due process were thus satisfied.

Dohany v. Rogers, 281 U. S. 362, 369.

Petitioners appeared and were heard both by the Superior Court and by the state Supreme Court; accordingly they are in no position to complain of lack of due process.

Doty v. Love, 295 U. S. 64, 74.

Whether the Superior Court had jurisdiction was a matter necessarily presented to it for determination at the very threshhold of the proceedings.

> "* * * The first point decided by any Court although it may not be in terms, is, that the court has jurisdiction, otherwise it would not proceed to determine the rights of the parties."
>
> *Clary v. Hoagland*, 6 Cal. 685, 688.

The Superior Court having decided that it did have jurisdiction, this question was inherently involved in the appeal taken by the petitioners to the state Supreme Court. Manifestly that court had jurisdiction to determine the jurisdiction of the Superior Court.

Smith v. Westerfield, 88 Cal. 374, 380-381;

Hochheimer v. Superior Court, 65 Cal. App. 206, 210;

Pacific Dry Goods Co. v. Superior Court, 9 Cal. App. (2d) 707, 711.

The Supreme Court of California by affirming the order decided that the Superior Court had jurisdiction.

Clary v. Hoagland, 6 Cal. 680, 687-688;

Scrimsher v. Reliance Rock Co., 1 Cal. App. (2d) 382, 393;

See, also:

Standard Oil Co. v. Missouri, 224 U. S. 270, 280-281.

Although the argument now advanced by petitioners was not urged in the state Supreme Court, a reference to the opinion shows that that court nevertheless express-

ly decided that the Commissioner's application (or petition) for his appointment as conservator was sufficient in substance.

The state Supreme Court reached the conclusion, and declared that all of Judge Edmonds' orders were void. [R. 1527]. It followed that (until August 11, 1936) the Commissioner was in possession of the assets of the Old Company without any valid order appointing him either conservator or liquidator. However, the state Supreme Court said:

> "In fact, the holding that all of the orders made by Judge Edmonds were void, does not even constitute a holding that the taking possession of the assets of the Old Company by Carpenter on July 22nd without a prior valid court order, was unlawful." [R. 1527.]

The state Supreme Court proceeded to hold that the taking possession was valid and lawful under Section 1013 of the Insurance Code which provides for a summary seizure [R. 1528]. The court then declared:

> "The petition for appointment as conservator *containing proper allegations,* was filed July 22nd." [R. 1528.]

Now, Section 1015 of the Insurance Code provides:

> "Immediately after such seizure, the Commissioner shall institute a proceeding as provided for in Section 1011 and thereafter shall proceed in accordance with the provisions of this article."

Later on in its opinion the state Supreme Court again referred to Section 1013 and epitomized the provisions of Section 1015 [R. 1533].

It is plain, we believe, that the state Supreme Court had in mind that a summary seizure under Section 1013 of the Insurance Code is valid and lawful only when proceedings are immediately taken under Section 1011 of that code, and that the state Supreme Court was deciding that an application proper under Section 1011 had been filed and that therefore the summary seizure was lawful.

This construction is borne out by other language in the opinion. The contents of the Commissioner's application for an order appointing him conservator are carefully and meticulously digested by the court [R. 1518]. Later in the opinion the court analyzed and examined Section 1011, pointing out the necessity for a verified petition "as was done here" [R. 1533].

We are not alone in our view that the state Supreme Court held in its opinion that the Commissioner's application for appointment as conservator was sufficient to vest the Superior Court with jurisdiction. This very point was urged in the Circuit Court of Appeals for the Ninth Circuit in the case of *Hutchins v. The Pacific Mutual Life Insurance Company of California*, 97 Fed. (2d) 58. In that case the appellant was a stockholder of the Old Company and appearing through her counsel, Messrs. Neblett, Warner & MacDonald (two of whom are petitioners herein), sought to set aside the state proceedings. Her contentions on the jurisdictional point and the answer of the Circuit Court of Appeals appear in the opinion of that court as follows:

> "In resisting the motion for leave to amend the appellees presented a number of affidavits. One of these contained excerpts from the petition of the commissioner filed in the state court. It was con-

tended on the argument that these excerpts disclose lack of jurisdiction in the state court to proceed. Without discussion of the point, it is enough to say that neither in the original nor in the proposed amended bill were any facts alleged disclosing lack of jurisdiction in the state tribunal, and the sufficiency of appellant's pleading was to be determined without reference to the contents of affidavits presented for another purpose. *It should be pointed out, however, that the Supreme Court of the state has determined that the proceedings were in conformity with the statute.*"

97 Fed. (2d) 60-61.

The determination that the Commissioner's application was sufficient in substance to satisfy the requirements of Section 1011 of the Insurance Code was peculiarly a matter of state law which it was the exclusive province of the state Supreme Court to determine, and that holding is conclusive here.

Ruhlin v. New York Life Ins. Co., 304 U. S. 202, 58 S. Ct. 860;

Erie Railroad Co. v. Tompkins, 304 U. S. 64, 58 S. Ct. 817;

North Laramie Land Co. v. Hoffman, 268 U. S. 276, 282.

The petitioners cannot convert this question of state law (jurisdiction of the state court) into a federal question. The federal question is necessarily grounded on the premise that under the state law the Superior Court never acquired jurisdiction. The Supreme Court of California having determined petitioners' premise against them, there is no ground for arguing the conclusion that they have

been deprived thereby of their property by an order made without jurisdiction—*i. e.*, as they say, without due process of law.

But in any event petitioners' contention is without merit. Section 1011 of the Insurance Code authorizes the Superior Court to appoint a conservator

> "Upon the filing, by the Commissioner, with the Superior Court in the county in which is located the principal office of such person in this state, of a verified application showing any of the following conditions to exist: * * *
>
> (d) That such person is found, after an examination, to be in such condition that its further transaction of business will be hazardous to its policyholders, or creditors, or to the public."
>
> *Insurance Code*, Sec. 1011.

The Old Company was a California corporation with its principal place of business in Los Angeles County [R. 2]. The Superior Court of that county was the proper court in which to commence these proceedings. In his said application the Commissioner alleged that he had made an examination of the business and affairs of the Old Company as of December 31, 1935, and had joined in a report of such examination, a certified copy of which was annexed to the application as Exhibit A [R. 3]. He alleged in the present tense "that said examination and report shows that respondent corporation *is* in such condition that its further transaction of business will be hazardous to its policyholders, its creditors, and to the public; * * *" [R. 3]. This application spoke as of the date of its filing, to wit: July 22, 1936 (21 Cal. Jur. 15). Subdivision (d)

of Section 1011 contemplates three steps in chronological order: (1) an examination and report; (2) a finding by the Commissioner (if warranted) that the company is in a hazardous condition, and (3) an application for appointment as conservator. Obviously an examination of a company of this size takes considerable time and, as is usual, the report is made as of a date previous to the completion of examination. These circumstances must be deemed to have been in the mind of the California Legislature when it enacted Section 1011. The mere fact that the report of examination was made as of December 31, 1935, is of no materiality. The report itself was completed on and is dated July 21, 1936, [R. 12] the day before the application was filed. The allegations of the application referred to, show that the Commissioner made an examination and that he found the company's business in a hazardous condition. This is sufficient under Section 1011.

Section 1011 of the Insurance Code further authorizes the appointment of a conservator

> "* * * upon the filing, by the commissioner, of a verified application accompanied by a certified copy of the commissioner's last report of examination of any person to whom the provisions of this article apply showing such person to be insolvent within the meaning of Article 13, Chapter 1, Part 2, Division 1 of this code * * *."

The Commissioner's application was verified [R. 9], the report annexed was a certified copy [R. 11], and the allegations in this regard were in the present tense [R. 3.] Section 1011 does not require that the Commissioner allege in his application that the annexed report is the last report. The application is sufficient if in fact the ac-

companying report is the last report of examination. The Superior Court found, presumably upon competent evidence, that the application was accompanied by a certified copy of the Commissioner's last report [R. 1001].

While we believe that the application complied literally with the provisions of Section 1011 of the Insurance Code, such literal compliance is not required. Proceedings of this nature are not a "verbal puzzle," a substantial compliance is enough.

Richardson v. Butler, 82 Cal. 174, 176.

Accord:

In re Arguello, 85 Cal. 151, 152;

Estate of Heydenfeldt, 127 Cal. 456, 458;

People v. Bank of San Luis Obispo, 154 Cal. 194, 201.

The cases cited by petitioners do not lead to a contrary conclusion.

In *Murray v. American Surety Co.,* 70 Fed. 341, the question was whether the plaintiff, purportedly acting as receiver of a state bank by appointment of a California state court, had capacity to sue. The Circuit Court of Appeals for the Ninth Circuit, *in the light of the decisions of the California courts,* held that under the particular statute involved there was no authority in the Superior Court to appoint a receiver.

Smith v. Westerfield, 88 Cal. 374, was an appeal from an order of the Superior Court sitting in probate and it was held that the court had acted in excess of its jurisdiction. However, the Supreme Court of California said:

> "Our appellate jurisdiction over the judgments of the Superior Court includes those in which that court improperly assumed jurisdiction, as well as those in which it was properly entertained."
>
> 88 Cal. 380, 381.

The case of *East Tennessee V. & G. R. Co. v. So. Tel. Co.,* 112 U. S. 306 (Pet. p. 34) has no bearing on the case at bar. There on appeal from a decision of the Circuit Court, this court held that the trial court, upon removal of a special proceeding from the state court, was limited by the applicable provisions of the state law.

Petitioners' quotation of the statement (Pet. pp. 34-35) that insolvency "proceedings are special, and no intendments can be made in favor of the jurisdiction," appears in *Daman v. Hunt,* 47 Cal. App. 274, 281, which relied on decisions of the Supreme Court under the California Constitution of 1849. It is to be noted that the Supreme Court of California, in denying a hearing in the *Daman* case, expressly withheld its approval of the very language quoted and relied upon by petitioners (47 Cal. App. 289, 290).

II.

The Orders Made by Judge Willis Are Valid and Do Not Depend Upon Void Orders Made by Judge Edmonds. Judge Willis Could and Did Validly Ratify the Acts of the Commissioner Including His Conveyance to the New Company on July 22, 1936. The Superior Court Obtained Jurisdiction Upon the Filing of the Commissioner's Application for Appointment as Conservator and the Appearance of the Old Company. The Fact That a Disqualified Judge Purported to Act on Said Application Did Not Divest the Superior Court of Jurisdiction.

Petitioners contend that Judge Willis subsequently approved Judge Edmonds' void orders, that the state Supreme Court erroneously held that such subsequent approval made the void orders valid (Pet. p. 39), and that it was a denial of due process to affect the rights of policyholders by void orders. They insist that *all the orders* affecting title to the assets and approving their transfer to the New Company were void because of the disqualification of the judge who made the orders (Pet. p. 36). In their supplemental brief petitioners amplify their contentons and now make the assertion that the *Superior Court of Los Angeles County* was without jurisdiction because of the disqualification of Judge Edmonds (Supp. Br. p. 18).

It will be recalled that Judge Edmonds on July 22, 1936, made an order purporting to appoint the Commissioner conservator and vesting title to all of the assets in him [R. 34, 36], and that thereafter Judge Willis approved the Commissioner's original plan and authorized the trans-

fer of most of such assets to the New Company [R. 103, *et seq.*]. Such transfer was then made by the Commissioner on July 22, 1936, by deed and bill of sale.[10] [R. 183-192]

The disqualification of Judge Edmonds having been discovered, Judge Willis on August 11, 1936, made his own order in which in the first paragraph thereof he purported to adopt, ratify and confirm Judge Edmonds' order appointing conservator, but in the second and subsequent paragraphs, he made the appointment *de novo* and vested the assets of the Old Company in the Commissioner as conservator [R. 325-326]. Except for two orders mentioned in the footnote,[11] the order of August 11th was the only order made by Judge Willis which purported by its terms to adopt, ratify or confirm any order made by Judge Edmonds.

Upon the Commissioner's petition therefor, submitting a revised plan of rehabilitation [R. 846, *et seq.*] which by

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[10]The Old Company joined in this conveyance [R. 190] but this is considered an immaterial circumstance.

[11]On August 29, 1936, Judge Willis made an order ratifying the intervention of the New Company and Judge Edmonds' order to show cause of July 23, 1936 [R. 828, *et seq.*]. This is of no importance. It merely gave standing to the various responses theretofore made to the order to show cause of July 23rd (including those of petitioners) and in fact was entirely superseded by Judge Willis' order to show cause dated September 25, 1936 [R. 905, *et seq.*]. On October 8, 1936, Judge Willis made an order amending *nunc pro tunc* Judge Edmonds' order appointing conservator dated July 22, 1936, and also his own order of August 11th [R. 997].

its terms was to become effective as of July 22, 1936, Judge Willis made an order directing that all persons interested should show cause why an order should not be made among other things ratifying the Commissioner's act in forming the New Company; ratifying, confirming and approving the transfer and conveyance heretofore made to the New Company (*i. e.*, the Commissioner's conveyance of July 22, 1936), and ratifying and approving the revised plan which by its terms was to become effective as of July 22, 1936.

The order of December 4, 1936, here under review, approved the acts of the Commissioner in forming the New Company [R. 1387] and in making the transfer of July 22nd [R. 1387-1388], and approved the revised plan [R. 1388].

It is upon the foregoing facts that petitioners base their contention that Judge Willis confirmed and ratified Judge Edmonds' void orders and that the Supreme Court held that he validly did so. They say, for instance, that the order to show cause of September 25th directed the parties interested to show cause why the void orders of Judge Edmonds should not be approved (Pet. p. 44), whereas the record clearly indicates that said order was to show cause why the acts of the Commissioner should not be ratified and confirmed [R. 906].

In respect to Judge Willis' order of August 11, 1936, [R. 322] appointing the Commissioner conservator, the state Supreme Court first pointed out that Judge Willis ratified Judge Edmonds' order appointing the Commissioner conservator and then called attention to the fact that Judge Willis made the order *de novo* [R. 1521-1522].

To emphasize the point the state Supreme Court further in the same paragraph of its opinion said:

> "It is to be noted that by this order of August 11th Judge Willis not only purported to confirm and ratify the prior order of Judge Edmonds, but also made his own order appointing Carpenter conservator of the Old Company." [R. 1522]

The fact that one severable paragraph of the order of Judge Willis purported to ratify the void order of Judge Edmonds obviously fails to affect the other severable paragraphs of the order of Judge Willis' proceeding *de novo* to appoint a conservator. *(California Civil Code,* Sec. 3537.) The pointed remark of the Supreme Court of California above quoted was consistent with its holding that

> "The validity of the subsequent proceedings is not dependent on the validity of any order made by Judge Edmonds. The subsequent proceedings before Judge Willis stand by themselves independently of the prior orders." [R. 1527.]

In respect to the proceedings of September 25, 1936, the state Supreme Court noted that the Commissioner had asked for an order to show cause "why all the prior acts of the Commissioner should not be ratified, confirmed and approved" [R. 1524], and on the same day the order to show cause was issued. In analyzing the order of December 4, 1936, here under review the state Supreme Court said that the trial court not only approved the Commissioner's plan

> "but also ratified, confirmed and approved all prior steps taken by him." [R. 1525]

There is no escape from the fact that the state Supreme Court (a) noted that Judge Edmonds made an order authorizing the transfer of the assets as provided in the original rehabilitation agreement [R. 1520] and that the New Company asserted title to such assets [R. 1521] (*i. e.*, that the transfer had been made); (b) expressly held that all of Judge Edmonds' orders were void [R. 1526-1527]; (c) adverted to the fact that the order appealed from ratified, confirmed and approved all of the prior steps taken by the Commissioner [R. 1525], and (d) affirmed said order [R. 1544]. There is nothing in the record to sustain petitioners' contention that Judge Willis in his order of December 4, 1936, confirmed or ratified or attempted to confirm or ratify any void orders of Judge Edmonds. Judge Willis in the order of December 4. 1936, ratified, confirmed and approved the acts of the Commissioner done under the apparent authority of said orders of Judge Edmonds, including the conveyance dated July 22, 1936. There is nothing in the record which sustains petitioners' contention that the state Supreme Court held that Judge Willis could or did validly ratify any of the void orders of Judge Edmonds. Indeed, it would seem that the state Supreme Court decided exactly to the contrary.

Petitioners assert (Pet. p. 44) that it was vital to the Insurance Commissioner that the void orders of Judge Edmonds be confirmed. Their argument seems to be that there was no possible theory by which the acts of the Commissioner could be ratified or confirmed unless the orders of Judge Edmonds were likewise approved and confirmed. This contention is untenable.

As we have seen, the state Supreme Court (without discussion of the doctrine of ratification) affirmed the order of December 4, 1936, here sought to be reversed on *certiorari*, which order expressly ratified the prior acts of the Commissioner including the conveyance of July 22, 1936. This is tantamount to a decision that the acts of the Commissioner could be ratified. Whether, under the circumstances in this case, the Commissioner's conveyance to the New Company dated July 22, 1936, as well as his other acts could be ratified was peculiarly a question of state law which, under the authorities we have cited under point I *supra* is conclusive on this court, and petitioners' contention does not present a federal question.

On the merits, said holding of the state Supreme Court was correct.

It should first be observed that the Commissioner's conveyance of July 22, 1936, in favor of the New Company and the execution of the original agreement for rehabilitation were both done *after* the Commissioner had filed his application for appointment as conservator and *after* the Old Company had appeared and consented to the granting of the prayer of said application [R. 34]. The filing of this application and the appearance of the Old Company gave to the Superior Court of Los Angeles County (as distinguished from any judge thereof) exclusive jurisdiction of the subject matter and the parties. *(Lion Bonding Company v. Karatz,* 262 U. S. 77; *Penn General Casualty Co. v. Pennsylvania,* 294 U. S. 189; *California Code of Civil Procedure,* Sec. 416.)

Petitioners assert that the Superior Court of Los Angeles County had no jurisdiction because of the dis-

qualification of Judge Edmonds, citing *Lindsay-Strathmore Irrigation District v. Superior Court,* 182 Cal. 315 (Supp. Br. p. 18). The case is squarely against them. In that case, after trial in the Superior Court of Tulare County, a peremptory writ of prohibition issued to the court and to the judge to refrain from further proceeding in said cause

> "except that if a qualified judge is called to act as judge thereof the court may proceed with a new trial of said action before such judge."
>
> 182 Cal. 337.

Thereafter a new trial was had in the *Superior Court of Tulare County,* Honorable Albert Lee Stephens, then a judge of the Superior Court of Los Angeles County sitting by assignment. An appeal was taken and the judgment was affirmed in part, modified and affirmed in part, and reversed in part, with directions to the trial court, *i. e.,* the Superior Court of Tulare County *(Tulare Irrigation District v. Lindsay-Strathmore Irrigation District,* 3 Cal. (2d) 489, at 502-503 and 582-583).

Petitioners say in their supplemental brief:

> "The jurisdiction which the Superior Court did not have is said to have been picked up and reclaimed by the order of Judge Willis on August 11th." (Supp. Br. p. 18.)

As we have pointed out, the jurisdiction of the Superior Court attached and became exclusive the moment the

Commissioner filed his application for an order appointing him conservator [R. 1, *et seq.*] and the Old Company appeared [R. 33]. Necessarily both of these acts took place, and the Superior Court of Los Angeles County as a court had jurisdiction before the disqualified judge attempted to act [R. 34].

The jurisdiction of said Superior Court was not exhausted by orders made by Judge Edmonds *(Tulare Irrigation District v. Lindsay-Strathmore Irrigation District,* 3 Cal. (2d) 489, at 502-503).

While the Commissioner's application for his appointment as conservator was thus awaiting action by the Superior Court of Los Angeles County he took certain steps under the apparent authority of the void orders of Judge Edmonds. The act of the Commissioner in making the conveyance of July 22, 1936, in favor of the New Company was not void, it was merely unauthorized because the Commissioner had not *then* been validly appointed conservator or vested with title or authorized to make the conveyance by a valid order of the Superior Court. A distinction must be made between the orders of the court, void because made by a disqualified judge, and the acts of the Commissioner, done pursuant to the apparent authority of those orders. It would, indeed, be an unusual doctrine which made the Superior Court, acting through a qualified judge, powerless to ratify, approve and confirm the acts of the Commissioner under those circumstances.

We can assume for the purposes of the argument that the Commissioner on July 22, 1936, until August 11, 1936, was an interloper in the affairs and business of the Old Company, that he was, in short, a trespasser without any right of possession or custody.[12] On August 11, 1936, the Commissioner became vested with title to all of the assets of the Old Company by virtue of paragraph 3 of Judge Willis' order of that date [R. 326]. (See Insurance Code Section 1011). The state Supreme Court so held [R. 1541]. Assuming that the Old Company up until August 11th could have successfully rescinded and annulled the Commissioner's said conveyance, this right of rescission necessarily passed to the Commissioner as conservator along with all the other assets of the Old Company *(Id)*.

In making the conveyance of July 22, 1936, the Commissioner acted on behalf of the Old Company, after first having filed his application for appointment as conservator, thus giving the Superior Court jurisdiction. His said conveyance was capable of being ratified and adopted by him, subject to approval of the court. The Commissioner, in his petition for approval of the revised plan of rehabilitation filed September 25, 1936, [R. 846, *et seq.*], informed the court of the transfer of assets he had made on July 22, 1936 [R. 850-851], and prayed for an order to show cause why the court should not make an order ratifying, confirming and approving said transfer [R. 853.]

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[12]It should be noted, however, that the state Supreme Court held as a matter of state law that the Commissioner was lawfully in possession during this period under the summary seizure provisions of the Insurance Code [R. 1528].

Thus the Commissioner for himself ratified and adopted his prior acts. Pursuant to said petition and said order to show cause, the trial court in the order here under review ratified and approved the said conveyance of July 22nd [R. 1387-1388], thus making the said conveyance valid as of July 22, 1936, under the doctrine of ratification. (*Compare Koontz v. Northern Bank*, 16 Wall. 196, 201.)

In addition to the doctrine of ratification (followed by the state Supreme Court without discussion) there is an additional doctrine not discussed in the opinion—that of relation back of title—which supports the judgment of affirmance and does not require a holding that void orders may be ratified.

In our brief in opposition to the petition for certiorari herein, we suggested that, by analogy to the Bankruptcy Act, it was possible that the title which vested in the Commissioner on August 11, 1936, related back to the moment when he filed his petition for appointment as conservator on July 22, 1936, prior to the execution of the conveyance of the same date (Said Br. p. 6). We cited in support of this suggestion:

Hiscock v. Varick Bank of New York, 206 U. S. 28, 40;

Acme Harvester Co. v. Beekman Lumber Co., 222 U. S. 300, 307;

Fairbanks Shovel Co. v. Wills, 240 U. S. 642, 649.

On further reflection, we are more firmly of the opinion that the Insurance Code can be construed to permit the application of the doctrine of relation back of title (compare Section 1019 of the Insurance Code), especially

where as here the interests of justice required the application of such doctrine.[18] (Compare *U. S. v. Anderson,* 194 U. S. 394, 399.)

In concluding the argument on this point we will notice briefly petitioners' contention that the only transfer of assets made by the Commissioner as conservator and/or liquidator to the New Company was by deed and bill of sale dated July 22, 1936, (Pet. for Cert. 8, 9, 13 and 37). The transcript of record naturally does not show what steps the Commissioner took after the order of December 4th was made, but it must be presumed in support of that order that the Commissioner, pursuant to express authority granted to him therein [R. 1388], executed such a new conveyance. In fact, the Commissioner subsequent to the order of December 4, 1936, and prior to January 7, 1937, did execute a new conveyance to the New Company [Supp. R. fol. 101]. But even if it be assumed that the Commissioner did not execute a new conveyance, this would furnish no ground for reversing the judgment of the state Supreme Court or the order of the Superior Court here under review. Surely a judgment is not to be reversed simply because the record may not show that it has been fully executed.

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[18]Necessarily in fairness to all persons interested their rights had to be fixed and the plan had to be made effective as of the day the Commissioner filed his application for appointment as conservator and the knowledge of the condition of the Old Company became public property. It would have been unjust and inequitable for the plan and agreement to fix the rights as of either August 11th or December 4, 1936, or any later date. Far from showing that the order of December 4th was void for this reason, it evidences the careful consideration of the equities given both by the Commissioner and the Superior Court, as well as by numerous attorneys who participated in the discussions at which this plan was formulated. See opinion of the trial court [R. 1470].

III.

The Commissioner Was Authorized During Conservation Proceedings to Operate the Business of the Old Company Through a Corporate Instrumentality, the New Company. The State Court's Decision to This Effect Does Not Violate the Due Process Clause of the Federal Constitution. Petitioners' Contention That Error Was Committed in This Regard Fails to Present a Federal Question; Neither Are Petitioners Aggrieved Thereby.

The state Supreme Court held that during the conservation period the Commissioner could and did lawfully conduct the business of the Old Company through his corporate agency, the New Company, and that the Superior Court validly approved such action [R. 1528-1529].

Relying on Section 1035 of the Insurance Code and two other California statutes petitioners contend that the decision of the state Supreme Court in this regard "is void because it is a direct violation of law" (Pet. p. 47) and that the state Supreme Court thereby failed to apply the due process guaranteed by the Federal Constitution.

It seems too obvious to require argument that the question whether the Commissioner could lawfully conduct the business of the Old Company through the instrumentality of the New Company was peculiarly a question of state law and required the interpretation of state statutes. Even if the interpretation were thought to be erroneous, that would not make the decision void. So far as this court is concerned, the state courts' interpretation of the state law

is conclusive. *(Ruhlin v. New York Life Insurance Co.,* 304 U. S. 202, 58 S. Ct. 860; *Erie Railroad v. Tompkins,* 304 U. S. 64, 58 S. Ct. 817; *North Laramie Land Co. v. Hoffman,* 268 U. S. 276, 282.) Petitioners do not contend nor could they logically contend, that if the California law is correctly determined by the state Supreme Court such law is unconstitutional. As in their first point they are attempting to endow a question of state law with qualities of a constitutional question.

The cases cited by petitioners (Pet. p. 47) are not in point. *Schecter v. United States,* 295 U. S. 445, (also cited in petitioners' supplemental brief, page 9, along with *Panama Pacific Refining Company v. Ryan,* 293 U. S. 388) involved distribution of power between President and Congress or between Congress and the administrative officers or commissions, and are "quite beside the point" when applied to a state statute *(Highland Farms Dairy v. Agnew,* 300 U. S. 608, 612). In *Hentschel v. Fidelity & Deposit Company of Maryland,* 87 F. (2d) 833, the Circuit Court of Appeals of the Eighth Circuit made some observations as to the power of the Missouri Superintendent of Insurance under Missouri statutes *Levezey v. Gorgas,* (Pennsylvania) 4 Dall. 71, was a decision by the High Court of Errors and Appeal of Pennsylvania passing on a matter of state law. In none of these cases did this court deny to a state court the power to interpret its own statutes or hold that a construction such as was here given to the Insurance Code was violative of constitutional rights.

The United States Government and its officers are more and more frequently using corporations as the instrumentality to carry out their duties. We have yet to learn that any of these laws are for that reason violative of the Federal Constitution. Surely if the California law permits it, as the state Supreme Court has held, that state and its Insurance Commissioner are not to be denied the use of this effective and efficient instrument.

Moreover, it does not appear that petitioners have been aggrieved by that portion of the decision which holds that the New Company was lawfully in possession during the preliminary period. Petitioners, as simple contract creditors, were not entitled to the possession of the assets during any of these times and the record is barren of any suggestion that their rights were impaired or prejudiced by reason of the operation. On the contrary, the opinion points out the benefits accruing from such procedure. [R. 1528].

The point urged by petitioners does not, we submit present a federal question.

IV.

The Asserted Error of the State Supreme Court in Construing the State Insurance Code So as to Permit the Rehabilitation of the Business of an Insolvent Insurance Company by Means of a New Company Does Not Present a Federal Question.

Petitioners assert that the state Supreme Court after a long and "erroneous discussion" of certain New York cases, declares that the Commissioner has the implied power to rehabilitate the business of an insurance company by means of a new corporation (Pet. p. 49). They insist that the New York cases do not support the decision and further that there are no powers which may be implied from a special statute. The portion of the opinion to which petitioners refer may be found at pages 1534-1538 of the record.

Again it must be pointed out that the state Supreme Court had plenary authority to construe the California statute. The contention that such construction is erroneous does not raise a federal question.

Quong Ham Wah Co. v. Industrial Commission, 255 U. S. 445, 448;

North Laramie Land Co. v. Hoffman, 268 U. S. 276, 282.

We are not here arguing that the state law as so interpreted is constitutional, as that question will be considered later in this brief. We are here simply answering petitioners' point that the state Supreme Court committed reversible error in construing the Insurance Code so as to authorize rehabilitation by means of a company organized for that purpose by the Insurance Commissioner.

V.

The Language of Section 1043 of the Insurance Code of California Providing That the Commissioner as Conservator or Liquidator, Subject to the Approval of the Court, May Enter Into Rehabilitation Agreements Is Not Vague or Uncertain and the Section Is Constitutional.

Section 1043 of the Insurance Code provides in part as follows:

> "In any proceeding under this article, the Commissioner, as conservator or as liquidator, may, subject to the approval of said Court, and subject to such liens as may be necessary mutualize or reinsure the business of such person, or enter into rehabilitation agreements. Such rehabilitation or reinsurance agreements shall provide that, subsequent to the date thereof and for such period of time as the Commissioner may determine, no investment or reinvestment of the assets of the person rehabilitated or reinsured shall be made without first obtaining the written approval of the Commissioner."

Petitioners assert that the clause authorizing the Commissioner as conservator or liquidator, subject to the approval of the court, to enter into rahabilitation agreements is so vague and uncertain that any action taken under it violates the first essential of due process of law, citing *Connally v. General Construction Co.*, 269 U. S. 385; *Cline v. Frink Dairy Co.*, 274 U. S. 445; *Standard Chemicals & Metals Corp. v. Waugh Chemical Corp.*, 231 N. Y.

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51, 14 A. L. R. 1054, and *Small Co. v. American Sugar Refining Co.*, 267 U. S. 233. (Pet. pp 49, 50; reasserted without argument, Supp. Br. p. 22.)

The first two cases cited reiterate the well-established rule, that a statute which either forbids or requires the doing of an act in terms so vague that men of common intelligence must necessarily guess at its meaning and differ as to its application, violates the first essential of due process of law. The other two cases cited hold that contracts are not void because in contravention of a vague and uncertain statute. None of these decisions has any application to the case at bar.

Section 1043 of the Insurance Code neither forbids nor requires the Commissioner to enter into rehabilitation agreements. Any such agreement cannot and does not become effective until approved by the Superior Court. The agreement in this case expressly provided that it should not become binding until it should have been approved by order of the court [R. 1442]. Neither the Commissioner nor the other party to the contract is placed in the peril of conforming to a vague or uncertain law, nor are policyholders or other persons interested placed under any such peril. Petitioners, who are here asserting the unconstitutionality of said Section 1043, are not required to take any action under the rehabilitation agreement until the court has acted.

Sections 1010, *et seq.*, of the Insurance Code provide a complete scheme for the conservation, rehabilitation and

liquidation of insurance companies in jeopardy. The Commissioner is necessarily given wide discretion, but this discretion is subject to the approval of the Superior Court. The authority contained in Section 1043 is a general grant of power to the Commissioner subject to the control and approval of the Superior Court in the first instance and the revisory powers of the state appellate courts in the second instance.

In 1935, when the Insurance Code, including Section 1043, was first enacted, the term "rehabilitation agreements," when applied to insurance companies, had a well-defined meaning. The New York Insurance law made provisions for rehabilitation and, as the state Supreme Court pointed out, it is upon the New York law that the California law is modeled [R. 1535]. Months before the California legislature met in 1935, the New York Insurance law had come before the Courts of that state, notably in the *National Surety* case (*Application of People, by Van Schaick*, 239 App. Div. 490, 268 N. Y. S. 88, affirmed 264 N. Y. 473, 191 N. E. 521). In the *National Surety* case the rehabilitation approved by the courts was effected by means of a new corporation.

VI.

The Business of Insurance Is Affected With a Public Interest. The State Has an Interest in the Rehabilitation of Insolvent Insurance Companies and May Protect and Advance That Interest Through the Exercise of the Police Power.

In *German Alliance Insurance Co. v. Kansas*, 233 U. S. 389, the plaintiff contended that an act of the State of Kansas regulating its rates was violative of the 14th Amendment to the Federal Constitution. It was urged that the business was private. This Court, speaking through Mr. Justice McKenna, said:

> "To the contention that the business is private we have opposed the conception of the public interest. We have shown that the business of insurance has very definite characteristics, with a reach of influence and consequence beyond and different from that of the ordinary businesses of the commercial world, to pursue which a greater liberty may be asserted. The transactions of the latter are independent and individual, terminating in their effect with the instances. The contracts of insurance may be said to be interdependent. They cannot be regarded singly, or isolatedly, and the effect of their relation is to create a fund of assurance and credit, the companies becoming the depositories of the money of the insured, possessing great power thereby and charged with great responsibility. How necessary their solvency is, is manifest. On the other hand to the insured, insurance is an asset, a basis of credit. It is practically a necessity to business activity and enterprise. It is, therefore, essentially different from ordinary com-

mercial transactions, and, as we have seen, according to the sense of the world from the earliest times—certainly the sense of the modern world—is of the greatest public concern."

233 U. S. 414-415.

The paramount interest of the state in insurance business, particularly in liquidation of insolvent insurance companies, is admirably stated in a comparatively recent decision of the California Supreme Court. *(Mitchell v. Taylor,* 3 Cal. (2d) 217.) The Court there said:

"That law provides that when there is insolvency or such situation as would make the further transaction of business by the insurer hazardous to its policyholders, its creditors or to the public, the Commissioner, with the aid of the Attorney General, shall institute a proceeding in the Superior Court placing him in possession of the company's property and seeking such other order as the interest of the policyholders, creditors and public may require. (Deering's Gen. Laws, 1931, Act 3739, Sec. 2.) Other provisions give him wide powers to carry out these purposes. There can be no doubt that the statute was enacted under the police power for a purpose connected with the public interest; that the legislature has declared the liquidation of insolvent insurance companies a matter in which the state has an interest; and that consequently it has made provision for a state officer to protect and advance that interest. The Insurance Commissioner is not a mere private trustee, or receiver wholly dependent on the appointing Court for his powers. He is a state officer, performing duties enjoined upon him by statute, and in their performance he acts on behalf of the state."

3 Cal. (2d) 218-219.

See, also:

O'Gorman and Young v. Hartford Fire Ins. Co., 282 U. S. 251;

Daniel v. Terrell (Texas), 93 S. W. (2d) 372.

In *Daniel v. Terrell, supra,* the Supreme Court of Texas held that the power of the state to fix title insurance rates operated upon contracts executed prior to the exercise of the state's power.

It follows from the authorities above cited that the business of insurance is affected with a public interest, that this public interest may be advanced and protected by the state through the exercise of the police power. Sections 1010, *et seq.*, of the Insurance Code deal with that particular phase of the insurance business having to do with the reinsurance, rehabilitation and liquidation of insurance companies in difficulties. Since the state may exercise control and regulate the rates and business of an insurance company solvent and in full operation, how much more so can it extend its assistance and protection to policyholders of an insurance company in financial difficulties. Then, most of all, the interposition of the state becomes essential.

The state, under its police power, had the right to determine under what circumstances an insurance company created under its laws could continue to do business. In the event the insurance company became insolvent or its business in a hazardous condition, the state under its police power could take over the business for the protection of all persons. Having done so, it was the duty of the state to avoid the disastrous consequences of liquidation and to preserve for the benefit of the policyholders full performance of the obligations of the contracts so far as possible. Rights of individual creditors must give way to the greater right of all creditors and to the interests of the state.

VII.

The Revised Plan of Rehabilitation and Reinsurance and the Order Approving the Same Do Not Impair Petitioners' Contracts, Deny Them Due Process of Law, Nor Deny Them the Equal Protection of the Law.

Petitioners contend (1) that the contracts of all policyholders have been impaired and that they have been denied the equal protection of the law because, they say, there never was any liquidator, consequently all of the policyholders were forced to assent to the plan or be left with absolutely nothing (Pet. p. 56; Supp. Br. pp. 23, 24).[14] They also contend (2) that their contracts have been impaired (a) because the benefits under the non-cancellable income policies have been cut down, and (b) because the New Company, without their consent, has been substituted as the other contracting party in the life policies (Pet. pp. 55, 56). Finally they assert (3) that their contracts have been impaired and that they have been denied due process of law because of the alleged unlawful discrimination between non-can policyholders and the other creditors (Supp. Br. pp. 21-25).

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[14]This contention was not urged to the state Supreme Court as is demonstrated by the fact that that Court, after a lengthy opinion in which it discussed the points raised *seriatim*, said: "We have considered *all* of appellants' contentions" [R. 1544].

A. The Alleged Non-existence of a Liquidator Did Not Impair Petitioners' Contracts nor Deny Them the Equal Protection of the Law.

Preliminarily it may be observed that the plan does not make acceptance of reinsurance compulsory on any policyholder. On the contrary, each policyholder is given the right to reject reinsurance and file a claim with the Commissioner thereafter to be appointed liquidator of the Old Company [R. 1440-1441].

It may also be conceded that no liquidator for the Old Company had been validly appointed prior to December 4, 1936, the date of the order approving the plan. The agreement was to be executed by the Commissioner as conservator and the subsequent step, that of appointing him liquidator, must necessarily follow chronologically after the approval of the plan. Both the order of December 4, 1936 [R. 1389], and the agreement itself [R. 1440-1441] contemplated that the Commissioner would in due course be appointed liquidator of the Old Company. In support of the judgment below it will be presumed that the Commissioner performed his duty and made application for liquidation, and that the Superior Court performed its duty and appointed the Commissioner liquidator.

Petitioners assert (Supp. Br. p. 23) that the fact that the Commissioner might be appointed liquidator at some future time, if it should appear to him that his efforts as conservator were futile, is immaterial; that constitu-

tional rights are guaranteed and cannot be made to depend upon the contingency of the Commissioner's discretion as to the futility of his own acts. This argument is without merit.

The Commissioner is the trustee for the benefit of all creditors and other persons interested (Ins. Code, Sec. 1057). The Superior Court may be considered the trustor (Civ. Code, Sec. 2252). If a liquidator be necessary for the complete operation of the plan and agreement, then there is an implied duty resting on both the Commissioner and the Superior Court to take the necessary steps for the appointment of the Commissioner as liquidator of the Old Company. In this regard the Supreme Court of California, in discussing the revised plan, said:

> "The proposal contemplates that in due course the Commissioner will be appointed liquidator of the Old Company and in that capacity will receive, liquidate and pay all claims against the Old Company * * *." [R. 1525.]

Obviously, in the light of the facts in this case and the decision of the state Supreme Court, the Commissioner would have no discretion except to ask for his appointment as liquidator, and the Superior Court would have no discretion except to grant such petition. Substantially all of the Old Company's assets having been transferred to, and its obligations having been assumed by, the New Company, further proceedings under Section 1011 of the Insurance Code would be futile as a matter of law (Ins. Code, Sec. 1016).

There can be no doubt that under the circumstances, if the Commissioner failed to apply for his appointment as liquidator, or, having applied, the Superior Court refused to appoint him liquidator, mandamus would issue from the state Supreme Court to compel the Commissioner and the Superior Court to perform their respective duties.

Bank of Italy v. Johnson, 200 Cal. 1, at 31;

Hilmer v. Superior Court, 220 Cal. 71, 73.

The state Supreme Court in its opinion expressly stated that dissenting policyholders

> "are allowed and will be paid the amount allowed by law as the measure of damages from the assets of the Old Company above enumerated."
>
> [R. 1539.]

If the appointment of a liquidator be necessary for the complete operation of the plan, the holding of the state Supreme Court above quoted is tantamount to a declaration that this step has been or surely will be taken. If, in order to support the judgment of the state Supreme Court it is necessary that a liquidator shall have been appointed, it will be presumed that subsequent to December 4, 1936, the Commissioner was appointed liquidator of the Old Company and that the state Supreme Court either took judicial notice of that fact or it was

called to its attention by concessions or admissions in the briefs. The opinion of the state Supreme Court does not say in so many words that a liquidator has been appointed. This is not surprising because the contention now advanced by the petitioners was not made before the state Supreme Court and is urged for the first time in their petition for writ of certiorari.

As a matter of fact, on January 7, 1937, the Commissioner filed an application in the Superior Court for liquidation of the Old Company and for his appointment as liquidator [Supp. R. fol. 1 *et seq.*]. On February 2, 1937, the Superior Court of Los Angeles County, per Judge Willis, made its order for liquidation appointing the Commissioner liquidator of the Old Company [Supp. R. fol. 99, *et. seq.*,]. Petitioners' appeals from said order [Supp. R. fol. 107; fol. 3 (L. A. No. 16245); fol. 3 (L. A. No. 16246).] are still pending and undetermined in the state Supreme Court.

Petitioners admit that the state Supreme Court held that the plan of rehabilitation contemplated the appointment of a liquidator but, they say, that fact is of no importance. They assert that their appeals taken from the order of December 4, 1936, to the Supreme Court of California deprived the trial court of jurisdiction to appoint a liquidator or to take any further action in the case (Supp. Br. p. 24).

It is not necessary to determine whether or not petitioners' assertion is a correct statement of the California law. If it be correct it means simply this, that the order of December 4, 1936 (admittedly contemplating the prompt appointment of a liquidator by a court then having jurisdiction to do so) impairs petitioners' contracts by failing to provide a liquidator when they themselves made such appointment temporarily impossible by taking an appeal from said order of December 4th.

The alleged non-existence of a liquidator does not furnish any ground for reversal. If the plan and the order of December 4, 1936, are otherwise unobjectionable, then the said order should be affirmed, for under petitioners' own theory the contemplated appointment can thereupon be made with due promptness. In short, petitioners have no need of a liquidator until it is determined by this court in this appeal whether or not petitioners are bound by the plan, at which time the Superior Court, under petitioners' theory, will be in a position to make, and for the reasons above given presumably will make, the contemplated appointment of a liquidator.

There is, therefore, no basis for petitioners' claim that their contracts have been impaired or that they have been denied the equal protection of the law because of the alleged non-existence of a liquidator with whom petitioners could file claims.

B. PETITIONERS' CONTRACTS HAVE NOT BEEN IMPAIRED.

1. *Petitioners Have No Vested Right in any Form of Remedy nor to Insist on Liquidation Instead of Rehabilitation. All They Are Entitled to Is the Equivalent of What They Would Have Received on Liquidation.*

Manifestly, none of petitioners' rights has been invaded by reason of the fact that the State of California, acting through the Commissioner of Insurance, took proceedings in July of 1936, under Sections 1010 *et seq.* of the Insurance Code dealing with conservation, liquidation and rehabilitation of insurance companies in jeopardy. So long as the Old Company was a going concern the policyholders had the right to have their contracts performed according to their face, but a circumstance intervened over which the state had no control and for which it was in nowise responsible, namely, the insolvency and hazardous condition of the Old Company. It could not continue to operate and the policyholders had no constitutional right to require it to operate. The Old Company's insolvency being a fact, the policyholders no longer had the right to compel a full performance of the policy obligations. All that they were entitled to was the equivalent of what they would have received on liquidation.

The policyholders were not entitled to any particular form of remedy at the hands of a particular state official, nor to insist on complete liquidation instead of rehabilitation. There is no property right in the constitutional sense in any form of remedy.

Gibbes v. Zimmerman, 290 U. S. 326;

Doty v. Love, 295 U. S. 64.

2. *As the Appeals Were Taken on the Judgment Roll and No Evidence Is Brought up, It Must Be Presumed That Assets Held by the Commissioner Will Be Sufficient to Pay the Dissenters as Much as, or More Than, They Would Have Received on Liquidation.*

The approved plan, as we have said, gave to policyholders of all classes the right to reject reinsurance and to file their claims with the Commissioner thereafter to be appointed liquidator.

The question, therefore, arises: Will dissenters, under the plan, receive the equivalent of what they would have received on complete liquidation? The state Supreme Court was of the opinion that the presumptions from the record required an affirmative answer to this question —that dissenters are allowed and will be paid the amount allowed by law [R. 1539].

The Commissioner, both as conservator and as liquidator, was a trustee for the benefit of all creditors (dissenters as well as consenters) and all other persons interested in the estate of the Old Company (Ins. Code, Sec. 1057). Upon his appointment as conservator he became vested with all of the assets of the Old Company. Under the rehabilitation and reinsurance agreement embodied in the approved plan he became obligated to, and presumably did, transfer to the New Company all of such assets, excepting the stock of the New Company and rights of action against the officers and directors of the Old Company and upon their fidelity bonds. The agreement, however, provides that the New Company shall pay or deliver to the Commissioner as liquidator the reserves established by the New Company behind each

policy held by a policyholder who rejects reinsurance. In addition, the New Company obligated itself to pay to the Commissioner for the benefit of dissenters a part of the future profits of the New Company. The Commissioner, as trustee, continues to hold the following assets:

(a) The stock of the New Company;

(b) Rights of actions against the officers and directors of the Old Company and upon their fidelity bonds;

(c) The obligation of the New Company to pay or deliver to the Commissioner the reserves behind each policy whose holder dissents;[15]

(d) The obligation of the New Company to pay to the Commissioner a proportionate share of substantially all of the net profits of the New Company from all its Departments, except the participating department, and 10% of the net profits from its assumed participating life policies.

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[15]Dissenters obtain the benefit of the liquidation of their share of the reserves through a going concern, the New Company. The New Company is obligated to pay such share to the liquidator in cash or deliver such share in kind selected by, and at a valuation satisfactory to, the Commissioner. If such share is delivered in kind, the Commissioner has a right at any time to require payment in cash or the substitution of other securities or assets at the valuation at which the first assets were received [R. 1424]. The New Company either pays in cash or in effect guarantees the value of the assets transferred in kind.

Although a trial was had lasting more than six weeks, none of the evidence was brought before the state Supreme Court and none of the evidence is before this court. The record does not disclose the value of the assets above listed. The record is also silent as to what amount the policyholders would have received had the business and assets of the Old Company been liquidated. The record does affirmatively show, however, that under the approved plan the assets are far in excess of what they would have been on liquidation [R. 1386]. In support of the order of the Superior Court, the state Supreme Court assumed that evidence was introduced on these vital points and that such evidence demonstrated that dissenters under the plan would receive as much as, or more than, they would have received on liquidation, and that the recitals of the order appealed from, that adequate provision is made in the plan for each class of policyholders, were amply supported by evidence [R. 1539]. This court must indulge in the same presumption. (Compare *O'Gorman & Young v. Hartford Insurance Co.*, 282 U. S. 251, 256-258.)

Moreover, the Superior Court adjudged that operations under the plan were feasible[16] and afforded a feasible method of providing within a reasonable time full restoration of the benefits under the non-cancellable income policies [R. 1387]. The obligation of the New Company to pay funds or deliver securities to the Commissioner sufficient to pay all of the claims in full becomes absolute

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[16]It was the exclusive function of the Superior Court to determine the feasibility of the plan. (*In re Hession* (C. C. A. 7th) 97 Fed. (2d) 902, 905; *In re Llewellin* (C. C. A. 7th) 86 Fed. (2d) 588, 590.)

and unconditional when the assumed non-can policies are fully restored [R. 1424]. The last mentioned adjudication of the Superior Court is, therefore, tantamount to a recital that the plan affords a feasible method of providing within a reasonable time full payment of all claims filed with the liquidator.

3. *If it Be Assumed That Assets Presently Payable or Deliverable to the Commissioner for the Beuefit of Dissenters Are Not Sufficient to Pay to Dissenters the Amount They Would Have Received on Liquidation, the Most That Can Be Said Is That Some Small Portion Thereof Has Been Placed at the Risk of the Business of the New Company for the Dissenters' Own Benefit, and This Is Not Unconstitutional.*

It will be observed that the obligation of the New Company to pay or deliver to the Commissioner as liquidator the reserves behind each policy whose holder dissents is not contingent upon profits to be earned by the New Company. The plan contemplates that the New Company will either make the collections and pay the share in cash or, in effect, will guarantee the value of assets turned over in kind at a price satisfactory to the Commissioner [R. 1424]. Said share of the reserves were free of expenses of conservatorship and liquidation expenses (including attorneys' fees) and were free from all preferred tax claims [R. 1421 and 1425-1426]. In the light of the recitals of the order here under review, namely, that there is no discrimination and that the assets will be more valuable under the plan than if sold on liquidation [R. 1386], it is to be presumed that the reserves so paid or delivered to the Commissioner for the benefit of dis-

senters will alone be greater than the dissenter's share on liquidation under forced sale. Even if it be assumed that such is not the case, then the most that can be said is that some portion of the assets, the proceeds of the forced sale of which on liquidation would be available for the claims of the dissenters, is placed at the risk of the business of the New Company.

But the mere fact that assets, which on liquidation would have been available for the payment of claims, are placed at the risk of the business of the New Company does not contravene the Federal Constitution.

Doty v. Love, 295 U. S. 64.

In *Doty v. Love,* an insolvent state bank, after being closed for several years, was reorganized under an act of the State of Mississippi passed after the bank became insolvent. Under this law the superintendent of banks, acting under the direction of the court of chancery, was permitted to form a new bank to take over and operate the business of the closed bank. At the time that the reorganization was proposed and approved by the court, all of the preferred claims had been paid. Stated as simply as possible the plan was as follows: The new bank assumed 25% of all of the remaining claims against the old bank, except claims of $5.00 or less, aggregating about $3600.00, which were assumed in full. In consideration of this assumption, assets in excess of the value of the proportionate amount of claims assumed were transferred to the new bank. Stockholders of the old bank purchased the stock of the new bank and contributed new money for that purpose and were relieved

of the stockholders' liability under the stock of the old bank. Assets of the estimated value of $45,000 belonging to the old bank were transferred to the new bank as a surplus for the capital account. The balance of the assets of the old bank were placed in a pool to be administered by the new bank as trustee for the creditors of the old bank and in this pool they shared ratably. The plan was compulsory upon all the creditors of the old bank. Two non-consenting depositors appealed to the Supreme Court of Mississippi, where the judgment was affirmed. (172 Miss. 342, 155 So. 331.) On appeal to this court it was urged, among other things, that appellants' pro rata share of the fund of $45,000.00 was placed at the risk of the business of the new bank. Article I, Section 10 and the Fourteenth Amendment of the Federal Constitution were invoked. It will be observed that this fund of $45,000.00 and the non-consenters' pro rata share thereof became part of the capital structure of the new bank and liable on a one hundred per cent basis for the new business of the bank. Non-consenters took the risk that this sum of $45,000.00, which was to be repaid to the depositors of the old bank out of profits, might never be repaid, either because of insolvency of the new bank or because no profits were enjoyed for a long period of time. But this was held not to infringe the Federal Constitution. The court said:

> "The argument is made that some of the assets of the old bank are placed at the risk of the business of the new one. All this was done for the protection of existing creditors. The finding is that collections

are made more promptly and readily by a going concern than by one in liquidation. Cf. *Christensen v. Merchants & Marine Bank of Pascagoula,* 168 Miss. 48, 57, 150 So. 375. For illustration, a live bank is more efficient than a closed one in selling parcels of real estate or in carrying them while unsold at profitable rentals. Adequate precautions are embodied in the plan to assure the enjoyment of these benefits by the creditors and not by others. It is one of the terms of the decree that none of the profits of the business may be used for the new shareholders until every dollar's worth of assets turned over by the superintendent has been paid to the creditors or delivered to the pool. The court may intervene upon a showing of unreasonable delay. There is no need to consider whether any of these safeguards might have been omitted without invalidating the plan. We take the record as we find it."

295 U. S. 71-72.

It should also be noticed that in the case at bar under no possible contingency will the stockholders of the Old Company receive one penny until every creditor has been paid in full, and the reserves are adequate for the full restoration of all benefits under the policies the holders of which elect reinsurance. By making this provision the plan avoids the objections found by this court to exist in the Northern Pacific reorganization (*Northern Pacific R. Co. v. Boyd,* 228 U. S. 482, cited by petitioners, Pet. p. 53).

C. THE APPROVED PLAN DID NOT DENY TO PETITIONERS DUE PROCESS OF LAW. IT WAS NOT UNJUSTLY OR UNLAWFULLY DISCRIMINATORY.

Holders of non-can policies, as we have said, have been extended the option to dissent and file claims, or to accept reinsurance by the New Company at scaled-down amounts. Other policyholders are given the option to dissent and file claims or to have their policy obligations fully assumed. The second question, therefore, arises: Is the plan unjustly discriminatory as to any class of creditors?

In determining whether the plan is unjustly discriminatory we must consider (1) the problem presented to the Commissioner and the objectives which equitably ought to be his goal; (2) the possible solutions available to the Commissioner, and (3) the extent to which the approved plan solves the problem and most nearly attains said objectives.

1. *The Problems Presented to the Commissioner and the Objectives Which Ought To Be His Goal.*

When the Commissioner, in July of 1936, found that the Old Company was insolvent and its business in a hazardous condition, it became necessary for him to take steps to protect the rights of all persons interested for whom he was the statutory trustee. The Old Company could not continue in active business [R. 849].

The Commissioner found that the Old Company had assets of the book value in excess of $200,000,000.00 [R. 5]; that it had obligations on policies issued and outstanding in excess of $600,000,000.00, insuring the lives of approximately 200,000 or more persons, and that it also had accident and health policies outstanding insuring an additional 75,000 persons [R. 6].

The Old Company had intangible assets of very considerable value, consisting of good will, going concern value and agency organization [R. 1386]. The Old Company's life policy business was very profitable [R. 846], and its commercial health and accident business had in recent years earned a profit of several hundred thousand dollars [R. 847]. The Old Company's insolvency was principally caused by the fact that it had been issuing non-cancellable health and accident policies at an inadequate rate. The Commissioner was faced with the fact that insurance is a public asset, a basis of credit and a vital factor in business activities, and that it provides income for the aged and subsistence for the widow and orphan.

The public policy of the state, as expressed in the Insurance Code, required the Commissioner to take active steps

The Commissioner's objectives were to preserve, if possible, the profitable business of the Old Company and the valuable intangible assets; to avoid a forced sale of the assets, and to secure as far as possible the benefits to policyholders provided in their contracts of insurance as fairly and as fully as the circumstances permitted.

At the direction of the court the Commissioner, in August of 1936, began a conference with interested parties and their attorneys. During this conference he gave diligent study and attention to the problems presented, he made diligent inquiry among possible reinsurers or purchasers for the purpose of determining what avenues were open. He invited the presentation of plans or offers and carefully examined and considered all plans and suggestions submitted to him [R. 851-852].

2. *The Commissioner Had Three Possible Solutions: (a) Complete Liquidation (Which Would Be Disastrous); (b) Ratable Assumption of All Policies (Which Would Destroy Intangible Assets and Would Merely Amount to Deferred Liquidation); and (c) a Plan of Rehabilitation by Which the Intangible Assets and the Profitable Business of the Old Company Would Be Preserved for the Benefit of All Creditors.*

The Commissioner had several options open to him.

First, and most obviously, he could completely liquidate the Old Company. Liquidation, however, would not solve the problems or attain the objects in view. It would be disastrous. The intangible assets would be lost along with the profitable business. The policyholders would have no option but to accept their distributable share of the assets, which on liquidation would be worth far less than on rehabilitation. Liquidation was something to be avoided if at all possible, as the public policy of the state, expressed in the Insurance Code, clearly demonstrates [R. 1534]. Obviously, since the Old Company was insolvent and since its tangible assets would bring substantially less on forced sale than if sold as a part of a going concern [R. 1386] and its valuable intangible assets would be entirely lost, the policyholders in the event of liquidation would receive less than the face amount of their provable claims and would never receive the performance of the obligations for which they had contracted.

Complete liquidation would have treated all creditors ratably and if the Commissioner had taken this easier path no claim could have been made of an unconstitutional infringement of the policyholders' rights, but the price paid by the creditors for this equality would be ruinous.

Secondly, the Commissioner could have reduced all policies ratably and thus preserved a theoretical equality among the creditors, but such option had insurmountable disadvantages and would not attain the beneficial objects sought to be gained. The holders of life policies who were still insurable risks would be induced by any such plan to surrender their policies and take insurance in other companies. On the other hand, those policyholders who were no longer insurable would tend to keep their insurance, even at the reduced benefits. The risks still insurable (which constitute the profitable business of the Old Company) would be lost and the unprofitable risks would remain an obligation at the reduced amounts. The Old Company obviously wrote insurance on the normal life expectancy tables. These tables assume that only normal surrenders and lapses of policies will occur, and that most of the risks which continue to be good risks will remain with the Company, thereby offsetting the risks which become poor ones. If, as a result of the reduction of the face amount of all policies, the good risks were lost, the normal experience tables would no longer reflect the mortality experience of the New Company and the reallocated reserves would tend to become insufficient. The result would be that the New Company would become insolvent because of inadequate reserves. In short, placing a ratable lien upon all policies or reducing ratably the amount of benefits on all policies might postpone liquidation temporarily, but would tend to make liquidation inevitable. Moreover, the valuable good will and agency

organization would be lost. It would, indeed, be difficult to write new business if the face amount of the life policies had been reduced proportionately.[17]

Any plan which provided for the ratable reduction of all policies would, as we have said, give a theoretical equality to all policyholders, life policyholders and non-can policyholders, dissenters and consenters, but obviously under such a plan the dissenter who elected to reject reinsurance at the ratably reduced amount and desired to file a claim would receive only the amount which he would have received if the company had been completely liquidated which, as we have suggested, would be less than the amount of his provable claim. A dissenter could not reasonably expect any share of the future profits of the business (whether operated by the Old Company or by a new company), for he had contributed nothing and was entitled to no further benefits.

A plan calling for ratable reduction of the face of all policies would not only make liquidation inevitable, with the attendant loss of benefits and disastrous consequences, but it would deny to the dissenter any hope of receiving his full measure of damages.

Thirdly, the Commissioner had the option to rehabilitate under a plan similar to the one approved. The New Company formed in rehabilitation could not assume one hun-

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[17]The State Supreme Court held that the evidence might well have shown that a ratable reduction of all policies would have many of the results above suggested [R. 1540].

dred per cent all of the obligations of the Old Company, for, if it did, the New Company would itself be insolvent. (*Thrower v. Kistler,* 14 Fed. Supp. 217.) It could not assume all of the obligations ratably and proportionately without the disadvantages mentioned in the discussion of the second option and the probability, if not certainty, of merely deferring the day when the New Company would, itself, become insolvent and have to be liquidated.

Since, for the reasons stated, the New Company could not assume all policies in full and, as a practical matter, could not assume all policies in part ratably and proportionately, there was but one alternative,[18] namely, the unconditional assumption of certain of the policies in full, and the conditional assumption in part of other policies with an obligation to restore these latter policies from the profits of the New Company.

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[18]There may have been other options open to the Commissioner. If there were, it will be presumed that they, as well as the first and second options, were considered by him and discarded for valid and substantial reasons [R. 852, 1271]. We do not suggest reinsurance by an established life insurance company as an option open to the Commissioner, because the principal plan of reinsurance (the so-called Giannini plan [R. 1350 *et seq.*]) was based fundamentally on the same principle as that adopted in the approved plan, namely, that the non-can policies should be scaled down. Moreover, in the light of the record, it was impossible for the state Supreme Court to consider the relative merits of the other plans submitted [R. 1544], and this court, not having any evidence before it, is in no better position.

3. *The Commissioner Submitted, and the California Courts Approved, the Revised Plan of Rehabilitation Whereby Liquidation (Either Immediate or Deferred) Was Avoided, and the Intangible Assets and Profitable Business Preserved for the Benefit of All Policyholders, Particularly the Holders of Non-can Policies. The Difference in Treatment Between Non-can Policyholders and Other Policyholders Was Necessary, Fair and Just and There Was No Unlawful or Unconstitutional Discrimination Against Them.*

Such were the problems and the objectives and the remedies available to the Commissioner. He adopted a plan conforming to the third option, presumably for reasons suggested above or other valid and substantial reasons supported at the trial by competent evidence.

In determining which policies should be assumed in full and which should be partially assumed, practical considerations made necessary that the non-can policies should be only partially assumed. Holders of non-can policies had been getting coverage at inadequate premium rates. The inadequacy of the premiums on the non-can policies stamped them as a burden rather than as a profit. These policies constituted the only unprofitable business which the Old Company had.

On the other hand, the life policy and the *commercial* health and accident business of the Old Company was very profitable. If this business could be conserved, if the life policyholders could be induced to continue their insurance and pay their premiums, if because this business had been completely assumed new business of similar nature would be encouraged (and it

is plain from the plan that the New Company does not contemplate writing new non-cancellable policies), then profits would be assured to the New Company and from these profits the plan contemplates that the consenting non-can policyholders will eventually be made whole and their benefits fully restored, and the dissenters who have filed claims will eventually be paid more than they would have received on complete liquidation, to-wit, the full amount of their measure of damages.

It must always be borne in mind that the vast majority of life policyholders must continue to pay premiums (and thereby be debtors of the insurance company) if they desire to obtain the full benefits of their policies. The very fact that the life policies were assumed in full and that the New Company's reserves behind these policies are entirely adequate, would induce life policyholders to continue the payment of their premiums, would discourage abnormal lapses, and would encourage new life business.

There is an important factor in this case which must never be lost sight of. The intangible assets, consisting of goodwill, going concern value and agency organization, which are of considerable value, by their very nature inhere in and are appurtenant to the profitable business of the Old Company. The record distinctly shows that the non-can policy business has been unprofitable and will always be unprofitable. It is a contradiction of terms to say that there is any going concern value to the non-can business which, by its very nature, can never earn a profit but has led to disaster.

Another factor of equal importance is that these intangible assets can be preserved only if the obligations of the profitable business are assumed in full. A life insurance company differs from the ordinary business. The goodwill and going concern value of a life insurance company are inseparably connected with the policyholders of the company who are its creditors. In the case of an ordinary business the goodwill and going concern value rest with the customers who are usually not the creditors, the creditors being an entirely different class and, moreover, the good will is somewhat speculative. In the life insurance business the customers are the creditors and the good will not only has reference to new business in the future, but is largely non-speculative because it inheres in business already on the books. Obviously, anyone taking over the profitable business, in order to make the value of that business any more than the forced sale value of the assets allocated to the profitable business—in order to preserve the going concern value, goodwill, agency organization and probability of future profits—must necessarily assume the obligations of this profitable business in full, otherwise the intangible assets are lost. The plan, by providing for the assumption of the obligations of the profitable business in full, thus preserves the valuable intangible assets, which would have been lost on complete liquidation.

The third important factor which must be borne in mind is that these intangible assets, which make possible the reasonable expectancy of future profits, are pledged

primarily for the benefit of consenting non-can policyholders and for the benefit of dissenters of all classes.

An analysis of the approved plan shows that it avoids immediate liquidation and a forced sale of assets and will avoid so far as possible deferred liquidation. It conserves the intangible assets and the profitable business of the Old Company. It makes possible with reasonable certainty the continuation of the New Company and the writing of new business. It presents and affords a feasible method of providing within a reasonable time full restoration of the benefits under the non-cancellable income policies [R. 1387] and therefore payment to dissenters of more than they would receive on liquidation, namely, the full face amount of their provable claims. It subordinates the rights of the stockholders to the rights of the creditors.

It is obvious from the plan and agreement that the New Company assumed the very largest obligation it could assume and still remain solvent. The plan was as fair a plan as was possible under the circumstances and still provide for the retention of the benefits it was intended to and does conserve, which benefits inure to all policyholders, consenters and dissenters alike.

The case at bar does not present a situation where there has been an arbitrary, unreasonable, unnecessary and non-beneficial difference in treatment between the creditors. The difference in treatment was justified for the reasons we have given above.

In closing our argument under this heading we cannot overemphasize the fact that acceptance of reinsurance was

not compulsory on any class of policyholders; that the plan and agreement avoids the disastrous consequences of liquidation, either immediate or deferred, and provides a fair and feasible method affording an opportunity of full payment of claims of dissenters and full restoration of benefits to the holders of non-can policies; that the plan and agreement avoids the disastrous consequences of forced sale of assets upon liquidation, conserves and preserves the valuable intangible assets and continues the profitable business as a going concern; and that complete assumption of the obligations of the profitable business was necessary to conserve the going concern value and make reasonably certain profits for the New Company, which profits largely inure to the benefit of the non-can policies whose holders consented to the plan, and to the dissenters. The difference in treatment was justified and, while it was beneficial to the holders of life policies who consented to the plan, that was not its principal object. The object was to provide a fund which would inure to the benefit of the non-can consenters as well as dissenters of all classes. The option selected by the Commissioner and approved by the Superior Court and the state Supreme Court was, as declared by both courts, fair, just and equitable and did not unlawfully or unjustly discriminate between any classes of creditors. The principle adopted in the plan and agreement was necessary under the circumstances and was the only principle which would avoid the disastrous consequences of liquidation and forced sale and preserve valuable assets.

VIII.

Apart From the Benefits Secured to the Non-Can Policyholders and Dissenters of All Classes, the Plan Was Entirely Equitable. The Decided Cases Show a Pronounced Trend Toward the Broad, Equitable Principle That Policyholders in Each Class Have a Preferred Claim to the Reserves Behind Their Policies, Over the Rights of the Policyholders of Any Other Class. The Court Should Not Hesitate to Apply This Principle to the Situation in the Case at Bar.

It is a recognized principle that the policyholder has a definite claim upon the reserves created by his premiums. The fundamental idea of the level premium plan is that the cost of insurance shall be equalized throughout the life. The excess of the premium payment over the actual cost of insurance in the earlier years is advance payment for the growing cost of the insurance in the later years and is a contribution to the reserves behind the policy. The theory of premium computation and reserves is set forth in considerable detail in *U. S. Life Insurance Co. v. Spinks* (Supreme Ct. of Ky.), 96 S. W. 889, and in *New York Life Insurance Co. v. Statham*, 93 U. S. 24.

The proprietary interest of the life policyholder in his policy reserves is recognized in many decisions—even where the policy did not provide for cash surrender and automatic nonforfeiture values.

In *New York Life Insurance Co. v. Statham, supra,* the court said:

> "This reserve fund has grown out of the premiums already paid. It belongs, in one sense, to the insured who has paid them, somewhat as a deposit in a savings bank is said to belong to the person who made the deposit. * * *
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> "To forfeit this excess, which fairly belongs to the assured, and is fairly due from the company, and which the latter actually has in its coffers, and to do this for a cause beyond individual control, would be rank injustice. It would be taking away from the assured that which had already become substantially his property. It would be contrary to the maxim, that no one should be made rich by making another poor."
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> 93 U. S. 34-35.

The California Supreme Court, in an action on a life policy to enforce nonforfeiture rights, said:

> "The purpose and object of the statute was to prevent a forfeiture of a policy by nonpayment of premiums, when there was a fund in the hands of the insurer *belonging to the insured* which might be applied to extend the insurance or purchase a paid-up policy. * * *
>
> "The statute was clearly intended to give the insured the benefit of such reserve, or surplus, by having it applied upon an extension, or a reinsurance, instead of having it returned to him."
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> *Nielsen v. Provident Savings Life Assurance Society of New York,* 139 Cal. 332, 337 and 338.

In *Henricks v. Metropolitan Life Insurance Company*, 7 Cal. (2d) 619, the California Supreme Court referred approvingly to *Inter-Southern Life Ins. Co. v. Omer* (Kentucky), 38 S. W. (2d) 931. In that case the Kentucky Supreme Court said:

> "A portion of the premiums paid is used to establish a reserve fund for the satisfaction and payment of the policies. * * * The recognition of the policyholder's interest in the reserves, that is, the portion which has been allotted to his policy, is demanded, and its forfeiture or confiscation prohibited by statutes enacted by most if not all the states under the police powers of government."
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> 38 S. W. (2d) 935-936.

This court in *Maryland Casualty Company v. United States*, 251 U. S. 342, said:

> "Reserves, as we have seen, are funds set apart as a liability in the accounts of a company to provide for the payment or reinsurance of specific, contingent liabilities. They are held not only as security for the payment of claims but also as funds from which payments are to be made."
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> 251 U. S. 352.

We do not wish to be misunderstood as asserting that any of the foregoing cases deal with factual situations analogous to the case at bar, for in none of the cases above cited was the court called upon to decide the relative rights of two classes of policyholders in the event of liquidation or rehabilitation. But we do most earnestly contend that they are guide-posts pointing unerringly to the fact that policyholders have a recognized and enforcible equity in the reserves behind their policies.

But an additional step was recently taken by the New York Court of Appeals in the case of *Rhine v. New York Life Insurance Co.*, 273 N. Y. 1, 6 N. E. (2d) 74, affirming 248 App. Div. 120, 289 N. Y. S. 117, followed and approved in *Rubin v. Metropolitan Life Insurance Co.*, 251 App. Div. 382, 296 N. Y. S. 908, affirmed 278 N. Y. 155, 16 N. E. (2d) 293. The *Rhine* case is important, and while it does not involve rehabilitation or liquidation, it is in point on principle and points unerringly, we believe, to the conclusion that the Superior Court herein was correct in making the order appealed from and the state Supreme Court correct in affirming the same.

In *Rhine v. New York Life Insurance Co., supra,* Mrs. Rhine held an ordinary life policy in the face amount of $2000.00. She exchanged this policy for two policies of $1000.00, each containing a disability clause. The premiums on each policy were exactly $2.96 higher than the premiums would have been if the policies had not contained the disability clause. Both policies participated in the profits of the company and were entitled to be paid policy dividends. For a number of years the dividends on both policies were identical with dividends on policies of the same amount and age class which did not contain a disability clause. But the experience of the company indicated that whereas the life business earned a profit, a different situation resulted in respect to the disability business, as to which the company was suffering a deficit. Prior to 1931 the company, in computing policy dividends, bulked all life policies of a given age class together, irre-

spective of whether the policies were with or without the disability clause. In 1931 it separated its life policies into two general classes—one, policies without the disability clause, and the other, policies with the disability clause. The result was that the policy dividends on life policies without a disability clause were larger than the dividends on life policies containing a disability clause. Plaintiff contended that both her policies should be treated in the same manner as if they had not contained a disability clause, and brought action to recover the difference in policy dividends. While the amount involved was merely nominal, the court of appeals pointed out that if the plaintiff's contentions were correct, the company would have to pay policy dividends of $15,000,000.00 among 1,600,000 policyholders. The court approved the plan followed by the insurance company and affirmed the judgment in its favor made by the Appellate Division, which had affirmed the judgment in the trial court in favor of the defendant.

This case is a clear recognition of the fact that a policyholder is entitled to policy dividends in accordance with the contribution he makes to the reserves behind his policy, and that a life policy without a disability clause may be put in a class different from a life policy with a disability clause. The importance of the case lies in the fact that the New York statute required that participation dividends should be "equitably" made (6 N. E. (2d) 75). The court refused to follow plaintiff's technical argument based on the wording of her policy, but employed broad equitable principles to reach a result which was fair to the policyholders as a whole. It is obvious that if a contrary result had been reached, holders of life

policies without a disability clause would have been contributing toward dividends of policyholders who enjoyed the additional protection.

It is interesting to note the history of the disability clause as set forth in the opinion, and particularly the fact that several great insurance companies found that disability insurance was impracticable and have discontinued issuing such policies.

Rhine v. New York Life Insurance Co. does not involve a liquidation or rehabilitation proceeding. But it does recognize the broad equitable principle that a policyholder has rights in the reserves behind, or created by, his particular kind of policy, and that a classification between policyholders is permissible in determining the amount of policy dividends.

It is really no step at all from *Rhine v. New York Life Insurance Co.* to the case at bar. The record clearly shows that the deficit arose by reason of actuarial undercalculation of the premiums payable on the non-can policies. For years the non-can policyholders had been getting insurance at bargain rates. The life policyholders have paid adequate premiums and will continue to do so in the future, contributing, under the Commissioner's approved plan, to making good the face amounts of the non-can policies.

The case here presented is an unusual one. The Old Company's business, in all departments except the Non-can Department, was profitable and in a flourishing condition. But by reason of the deficit in reserves behind the non-can policies, it could not continue in California or most of the other states in which it did business. The problem presented was in many ways unique, and while,

as we will presently show, there are precedents in New York for the act taken by the Commissioner, nevertheless upon principle the state courts were justified in approving the Commissioner's revised plan.

The unusual circumstances in this case would have required the approval of the plan upon the application of broad principles of equity, even if no precedents squarely in point exist. The California Supreme Court recently announced that principle of law, in no uncertain terms, when, in *Times-Mirror Co. v. Superior Court,* 3 Cal. (2d) 309, it said:

> "Equity does not wait upon precedent which exactly squares with the facts in controversy, but will assert itself in those situations where right and justice would be defeated but for its intervention. 'It has always been the pride of courts of equity that they will so mold and adjust their decrees as to award substantial justice according to the requirements of the varying complications that may be presented to them for adjudication.' (Humboldt Sav. Bank v. McCleverty, 161 Cal. 285 [119 Pac. 82], citing Story's Equity Jurisprudence, secs. 28, 439; 1 Pomeroy's Equity Jurisprudence, sec. 60.)".
>
> 3 Cal. (2d) 331.

It is obvious from the record that the Insurance Commissioner of the State of California, on whom the initiative lay, molded and adjusted the revised plan of rehabilitation so as to do substantial justice in the complicated situation presented to him. The Superior Court, after a six-weeks trial, approved the plan as fair, just and equitable, and the state Supreme Court has affirmed that order.

IX.

Similar Proceedings Have Been Upheld in Other Jurisdictions.

Perhaps one of the leading cases in the United States on the rehabilitation of an insurance company is *Re National Surety Company*, 268 N. Y. S. 88, affirmed by memorandum opinion, 191 N. E. 521, on the authority of *People v. Title & Mortgage Guarantee Co. of Buffalo*, 190 N. E. 153. In New York the Superintendent of Insurance, as a first step, becomes a rehabilitator. As rehabilitator he performs the duties of a conservator as it is known under the California statute. Rehabilitation under the New York law includes conservation as well as rehabilitation in the sense in which it was used in the proceedings below. The *National Surety* case involved rehabilitation in the latter sense. It is particularly in point as there was an alleged discrimination in favor of surety business which could be taken over by the new corporation and carried on at a profit.

The Superintendent of Insurance of the State of New York found that National Surety Company, a New York corporation, was insolvent. However, the company was engaged in a nation-wide business of great magnitude and had a good will of great value, and the Superintendent moved swiftly to preserve the business and conserve the assets.

As statutory rehabilitator under court appointment, he proposed a plan to conserve the assets of the company by organizing a new corporation designated "National Surety Corporation," with a capital of one million dollars and a surplus of three million dollars paid in from the assets of National Surety Company in exchange for all of the stock

of the new company which was issued in the name of the rehabilitator for the protection of all concerned; by having the new company assume a portion of the liabilities of the old company; by creating a second corporation to liquidate certain mortgage guaranties of National Surety Company out of certain assets transferred to that corporation by the company; and by creating a third corporation to take over certain frozen assets of National Surety Company and to pay therefrom obligations not assumed by National Surety Corporation or by the corporation liquidating the mortgage guaranties. The losses assumed by National Surety Corporation were only those which would occur after May 1, 1933, under various insurance contracts of National Surety Company.

It was contended by certain policyholders that the plan was inequitable, illegally discriminatory and unconstitutional. It was held, however, that "rehabilitation" means conservation of assets and resumption of business; that rehabilitation was a step toward the removal of the causes which made the state proceeding necessary; that the statute empowered the Superintendent of Insurance to act quickly and contemplated that he would so act to preserve the going concern values; that rehabilitation required a wise use of discretion by the Superintendent; that the legislature had the power to permit the Superintendent to rehabilitate or liquidate an insurance company; that a new company could be organized to receive the assets of the company in rehabilitation and to save its good will and profitable business; that the assets of the company so transferred could be so used for the purpose of rehabilitation; that the new company and the transfer to it constituted a proper method of safeguarding the rights of creditors; that the court must rely to a great extent on

the Superintendent who had the facilities to acquire information with reference to the needs of the situation and that the plan seemed to the court to be feasible and was an act of conservation for the benefit of all concerned; and that rehabilitation accomplishes a great public service.

Re National Surety Company, 268 N. Y. S. 88.

An appeal was taken from the order of the Supreme Court approving the plan of rehabilitation, and the holding of the lower court was affirmed, the upper court declaring that the Superintendent had the power to adopt the plan and that the plan was a proper exercise of that power.

Re National Surety Company, 191 N. E. 521, following

People v. Title & Mortgage Guarantee Co. of Buffalo, 190 N. E. 153.

Thereafter the National Surety Company rehabilitation plan was subjected to attack in Kentucky where the company had been engaged in business and where the new company, National Surety Corporation, had been licensed to carry on the business of the old company. Referring to the plan, the Kentucky court said that it evidenced "fairness toward the holders of claims as well as due consideration for the protection of their rights"; that the new company became possessed of the valuable good will of the old company and thereby were preserved the potential profits that might arise from the continued operation of the business of the old company; that the good will and those potential profits would have been completely lost if

the old company had gone into liquidation; and that the plan effected the greatest possible salvage of the assets of the old company.

It was also held, upon the authority of *Hartford Life Insurance Co. v. Ibs,* 237 U. S. 662, that the intervention of creditors in the New York rehabilitation proceeding was for the benefit of all the creditors of the respective classes and gave the New York court jurisdiction of all creditors of all those classes; and also that personal service of process was unnecessary and that the order of the New York court, having jurisdiction of the subject matter and the various creditors, was binding upon all creditors wherever residing and was entitled to full recognition in Kentucky under the full faith and credit clause.

National Surety Corp. v. Nantz, 90 S. W. (2d) 385.

The legality of the National Surety Company rehabilitation plan was also challenged in the United States District Court for South Carolina. That court observed that National Surety Company was faced with immediate liquidation or reorganization; that a forced liquidation would probably have resulted disastrously to creditors and probably would have meant "the complete sacrifice of the good will of the company built up over many years and its value as a going concern"; that liquidation would have had a "terrifying effect on other surety companies, thus further paralyzing the business of the Nation"; and that "liquidation would have been destructive of the interests of the creditors."

Of the New York plan of rehabilitation the District Court said that National Surety Corporation was created "for the purpose of continuing the business of the old

company as far as practicable and to preserve from the disastrous effects of forced liquidation many of its valuable assets"; that "a large part of the value of a surety company is its good will as a going concern, and upon liquidation such value entirely disappears"; that "by continuing the business, with the same agency setup, the demand for return premiums is in the main eliminated, and there is no serious interruption of the normal flow of business"; and that the new company could not assume all the liabilities of the old company, "for if it had done so there would have been no substantial change in the status and the new company would have been unable to function."

Thereupon that court concluded that the rehabilitation transaction was entirely free from fraud or any other unlawful conduct on the part of the New York Superintendent of Insurance or the old company; that the creditors of the old company became the owners of the business of the new company; that the new company was a going concern, with reasonable prospects of success; and that in liquidation little or no salvage could have been expected.

Thrower v. Kistler, 14 Fed. Supp. 217.

Doty v. Love, 295 U. S. 64, has already been cited and relied on earlier in this brief. It involved a rehabilitation of an insolvent bank under a statute providing for "freezing of deposit agreements" under the direction of the Superintendent of Banks, supervised by the Court of Chancery.

X.

It Is Too Late for Petitioners to Urge, as They Do in Their Supplemental Brief, That Section 1011 of the Insurance Code Is Unconstitutional. In Any Event Their Contentions in That Regard Are Without Merit.

Under Point II of their supplemental brief (pp. 7-9) petitioners contend for the first time that since, as they say, it is mandatory upon the Superior Court to appoint the Commissioner conservator and vest title to the insurance company's assets in him upon his filing the application, that section is unconstitutional, violates the due process clause and impairs the contracts of the policyholders, and is an unconstitutional delegation of legislative power to an administrative officer. They also assert (Supp. Br., Point III, pp. 10-16) that Section 1011 is unconstitutional because, as they say, it authorizes the Insurance Commissioner to make findings without notice or hearing on the question whether the insurance company is in a hazardous condition or is insolvent and, further, that in the case at bar that the Commissioner took no evidence but, nevertheless, made the finding in violation of the rules laid down in the Kansas City stock yard cases (*Morgan v. United States* (first appeal), 298 U. S. 468; second appeal, 58 S. Ct. 773; on rehearing, 58 S. Ct. 999).

The contention that Section 1011 of the Insurance Code is unconstitutional should not be considered by this court for the following reasons: (1) The contentions above stated were not raised before the state Supreme Court; on the contrary, petitioner Neblett, in the oral argument before the state Supreme Court, conceded for himself, at least, that the provisions of the Insurance Code are valid and constitutional [R. 1532]. (2) The point was not

suggested in the petition for *certiorari*. (3) It was not mentioned in petitioners' specifications of error (Pet. p. 28). (4) It was not argued in their brief in support of the petition for *certiorari*.

Under such circumstances the point should not be considered by this court.

Clark v. Willard, 294 U. S. 211, at 216, and cases cited.

Petitioners' contentions, however, on the merits are not well taken.

Under Section 1011 of the Insurance Code the Superior Court shall appoint the Commissioner conservator and vest title to the assets of the insurance company in him as such conservator (*inter. alia*) (a) when as a result of an examination he has found the insurance company's business to be in a hazardous condition, or (b) when his last report of examination shows said company to be insolvent. The Superior Court does not, as contended by petitioners, act merely in a ministerial capacity (Supp. Br, p. 12). If that were so, how could Judge Edmonds have been disqualified to make the order appointing the Commissioner conservator? The Superior Court sits as a judicial body and determines in fact whether the Commissioner has made a *prima facie* case under Section 1011 of the Insurance Code. If the Superior Court determines that a *prima facie* case has been shown, the order appointing conservator and vesting assets is made because it is a proper case under Section 1011 for such an order to be made.

Section 1011 of the Insurance Code must be read in connection with the next succeeding section. Section 1012 of said code provides that the order appointing

conservator shall continue in force and effect until, on the application of the Commissioner or of the insurance company, it shall

> "after a full hearing, appear to said court that the ground for said order directing the Commissioner to take title and possession does not exist or has been removed and that said person [insurance company] can properly resume title and the possession of its property and the conduct of its business."

Under these two sections (a) the court is authorized, upon a proper showing by the Commissioner, to appoint a conservator and, *for this purpose only,* the allegations in the Commissioner's application are given conclusive effect, (b) neither the order appointing the conservator nor the allegations contained in the Commissioner's said application are conclusive on the insurance company, for the latter may immediately move for a full hearing under Section 1012, where the court hears evidence and may dissolve the conservatorship.

The legislature deemed it advisable that when any of the conditions mentioned in Section 1011 of the Insurance Code were made to appear by the verified application of the Commissioner, an order appointing conservator should be made, reserving, however, to the insurance company full rights to have the order dissolved. This is nothing more than the common case of an appointment of a temporary receiver *ex parte* with the right to the defendant to move for a dissolution of the receivership.

This discussion is more or less academic in this case, for the Old Company appeared and consented to the appointment of the Commissioner as conservator [R. 33].

It is not a legislative function for the Commissioner "to take evidence *ex parte* and to find facts upon which

the court must forfeit the title of an insurer to its properties * * *" (Supp. Br. p. 9), as petitioners erroneously suppose. Nor does the Commissioner act in a judicial or *quasi-judicial* capacity. He acts purely as an administrative officer. Through his deputies he makes an examination of the insurance company, much as the Comptroller of the Currency examines national banks through his bank examiners.[19]

The Kansas City stock yard cases (*Morgan v. United States, supra*) present an entirely different situation. There the Secretary of Agriculture acted in a *quasi-judicial* capacity in fixing rates and the statute provided for a "full hearing" at which evidence should be taken (298 U. S. 473). The Secretary's determination of the facts was made conclusive (298 U. S. 477). The decisions of this court were grounded upon the fact that no "full hearing" had been accorded to the petitioners therein.

In the case at bar petitioners assume that someone (who, they do not state) should have been given notice of the Commissioner's examination and an opportunity to be heard, and they insist that, for lack of such notice and hearing, constitutional rights have been violated [Supp. Br. p. 8]. The vice of this argument is (1) the assumption that the Commissioner's examination, upon which his application for appointment as conservator is predicated, is a *quasi-judicial* proceeding, and (2) that

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[19]In *Bushnell v. Leland*, 164 U. S. 684, it was held that the Comptroller of the Currency did not exercise judicial power in violation of the Federal Constitution, because under the National Bank Act he was empowered to appoint a receiver to a defaulting or insolvent national bank without a previous judicial ascertainment of the necessity for the appointment (164 U. S. 685).

they, as policyholders, are entitled to notice and an opportunity to be heard.

(1) As we have pointed out, the Commissioner, in making his examination, is acting purely in an administrative capacity, collecting facts and making an examination which will enable him to make a *prima facie* case for his appointment as conservator.

(2) But, even if it be assumed that the examination was in the nature of a *quasi-judicial* proceeding, petitioners as general creditors were not entitled to notice or to participate in such hearing. They were represented by the Commissioner, their trustee (Ins. Code, Sec. 1057). The only person entitled to notice and an opportunity to be heard was the Old Company. It is absurd to suppose that the Commissioner's report and examination of the Old Company's books was made without the knowledge of the Old Company. In any event, the only person who could raise this constitutional objection was the Old Company (*Jeffrey Mfg. Co. v. Blagg*, 235 U. S. 571, 576; *Dahnke-Walker Co. v. Bondurant*, 257 U. S. 282, 289), and it has not done so. Moreover, petitioners were given the opportunity to have the Old Company's insolvency and hazardous condition determined by the trial court. Petitioner Neblett embraced this opportunity [R. 248], as did other interested parties [R. 270-271]. The trial court decided the point against them [R. 1385-1386]. Where only property rights are concerned, mere postponement of judicial inquiry is not a denial of due process. (Compare *Phillips v. Commissioner*, 283 U. S. 589, 596-597.)

Even if the petitioners' contention that Section 1011 of the Insurance Code is unconstitutional could be raised at this late date, it is entirely devoid of merit.

XI.

Reply to Brief Filed by Respondent George I. Cochran.

After this brief had been set in type, respondents Day *et al.* were served with a copy of the brief of respondent George I. Cochran, in which he argues in support of petitioners' position, espousing particularly the cause of the non-can policyholders.

In order to keep the record clear we call the following facts to the court's attention: Mr. Cochran (others with him) filed a complaint in intervention [R. 233 *et seq.*] and responses respectively to the orders to show cause of July 23, August 13 and August 14, 1936 [R. 716 *et seq.*, 791 *et seq.* and 797 *et seq.*, respectively]. While certain of these pleadings invoked the Federal Constitution, none was filed in reference to the Commissioner's approved plan submitted September 25, 1936 [R. 904]. He took no appeal to the Supreme Court [R. 1525], nor did he or anyone in his behalf file a brief either in opposition to or in support of the order appealed from (10 Cal. (2d) 313). On July 22, 1936, he was Chairman of the Board of Directors of the Old Company, and prior to that time had been president. He was a stockholder and sued in that capacity in his first pleading [R. 233]. He was also a holder of a life policy [R. 717] but (so far as the record shows) *did not hold a non-can policy.*

So far as he files his said brief to protect his own interests as a life policyholder and stockholder (Cochran's Br. p. 2), it would seem that he is precluded by his failure to appeal and his failure to petition for writ of certiorari (compare *Alexander v. Cosden Co.*, 290 U. S. 484, at 487, and cases cited).

Under these circumstances we do not believe that Mr. Cochran should be permitted to file a brief. However, if we are incorrect in our view and the court considers said brief, we tender this as our answer to Mr. Cochran's two contentions (A and B).

A. Under his Point A, Mr. Cochran contends (1) that Section 1043 of the Insurance Code makes no provision for the "reorganization" of an insurance company (Cochran's Br. p. 7), and that (2) if the legislature has made such provision, then this amounts to an unlawful delegation of legislative power.

The difficulty with Mr. Cochran's first position is that the state Supreme Court expressly held that the Insurance Code

> "when read as a whole discloses a clear and unequivocal intent to preserve whenever possible the 'business' of the insolvent company, and if to preserve such business—if to rehabilitate such business—a new corporation must be organized, the power clearly exists." [R. 1537-1538.]

The construction of the Insurance Code was plainly within the exclusive authority of the California Supreme Court and the contention raised that the Insurance Code was incorrectly construed by the state Supreme Court does not present a federal question (see authorities cited under Point IV, *supra*). (2) The alternative contention urged, namely, that if the statute can be construed to authorize the Commissioner to propose a plan of "reorganization,"

it is an unconstitutional delegation of authority, does not present a federal question.

Dreyer v. Illinois, 187 U. S. 71, 83-84;

Crowell v. Benson, 285 U. S. 22, 57;

Highland Farms Dairy Inc. v. Agnew, 300 U. S. 608, 612-613.

B. Mr. Cochran's Point B, based on the "contract clause" of the Federal Constitution, is an enlargement of or an addition to petitioners' argument under their Point J (Pet. pp. 55-56) and a portion of their Point IV (Supp. Br. pp. 21-23). Our Points VI, VII, VIII and IX, *supra,* respond to petitioners' point that their contracts have been impaired. New suggestions made by Mr. Cochran will be briefly answered.

As we understand Mr. Cochran's argument (Cochran's Br. pp. 20-23), it is that on liquidation the dissenting non-can policyholders have a right to look to the entire assets of the Old Company for the satisfaction of their claims, whereas under the plan they are limited to a special fund (said Br. p. 22). He contends (said Br. p. 20) that this special fund consists of (a) the non-can dissenters' share of the reserves behind the non-can policies, which reserves are set up only to the extent required after the reduction of benefits, and (b) further payments out of funds available for general corporate purposes, subject to what he declares "a very effectual limitation" (said Br. p. 20).

He then argues that the aggregate measure of damages on all non-can policies should equal the sum of $23,000,000, the amount by which the Commissioner found the non-can reserves to be inadequate. Consequently, he says, the

non-can policyholders have not been offered an alternative as claimed by the state Supreme Court.

The vice in Mr. Cochran's argument is obvious. In a case of liquidation the non-can policyholder would not share in the "further payment" to be made to the Commissioner by the New Company out of its future profits *because in the event of liquidation there would be no future profits.* These "further payments," said by Mr. Cochran to be subject to "a very effectual limitation," are made out of funds not reasonably required for the reasonable, proper and profitable conduct of the operations of the New Company as a going concern [R. 1416]. It is no part of the plan that the New Company shall hazard its existence as a going concern in order to enlarge said "further payments." The preservation of the going concern value and other intangible assets was one of the main objectives attained (held the trial court [R. 1386]) by the approved plan.

Mr. Cochran also overlooks the fact that there are other assets in the hands of the Commissioner, to wit, the stock of the New Company and causes of action against the former officers, etc., of the Old Company and upon their fidelity bonds.

In respect to the deficit in the non-can reserves of $23,000,000, which Mr. Cochran asserts is the aggregate on non-can claims, he overlooks the fact that (a) the computation of the deficit in non-can reserves was made *before* the sum of $1,792,118.97 was transferred to health and accident (including non-can) reserves [R. 1410]; (b) the court made no adjudication of the amount by which the reserves were inadequate or the Old Company insolvent [R. 1000-1001 and 1385-1386] and that for aught that

appears from the record the evidence may have shown that the reserves were not as inadequate as first determined by the Commissioner; (c) the percentage of benefits on non-can policies unconditionally assumed by the New Company may have been conservatively estimated in order that the New Company would be certain not to become insolvent in respect to its unconditional partial assumption of consenting non-can policies.[20]

The aggregate measure of damages of all non-can policies suggested by Mr. Cochran to be $23,000,000 (Br. p. 23) is not only erroneous as a matter of fact in the respects above specified, but the question has not been passed on by the California courts or, we understand, by any other court.

In any event, the measure of damages is only one of the factors which determine the amount which policyholders would receive in the event of liquidation. Another and very important factor is the amount which the assets would bring on forced sale. In respect to this factor the record is silent, except that we know that the assets of the Old Company would be of substantially less value if they were sold separately or in separate units or parcels than if sold as a going concern [R. 1386, 1389].

Mr. Cochran also argues (said Br. p. 21) that there is a discrimination between *dissenting* life policyholders and

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[20]This is a reasonable assumption and, if true, would not harm the non-can policyholders whether they dissent or consent, because the profits from the non-can policies inure ratably to their benefit.

dissenting holders of non-can policies, upon the ground that the share of the reserves payable to the Commissioner as liquidator is larger in the case of life policies than in the case of non-can policies. There is no basis for any such argument. There is nothing in the plan that provides that the Commissioner shall prefer the claims of dissenting life policyholders over those of dissenting non-can policyholders. All dissenters share ratably in the reserves transferred to the Commissioner without regard to the source of such reserves.

Concluding his argument, Mr. Cochran says (contrary to the holding of the state Supreme Court) that "non-can policyholders have not been offered an alternative * * *. They really were offered no alternative at all" (said Br. p. 23). Against this opinion of Mr. Cochran, *who is not a non-can policyholder and therefore never faced the necessity of making the selection of an alternative,* we oppose the practical consideration that of the many thousands of non-can policyholders who actually were faced with the alternative and who had to determine as a *personal, practical and dollars-and-cents matter* whether the plan offered a real alternative, only three non-can policyholders, Messrs. Bettin, Dickinson and MacDonald, appealed from the order of December 4, 1936, or petitioned this court for certiorari. Against Mr. Cochran's opinion we likewise oppose the decision of the state Supreme Court on that very point [R. 1539] and the adjudication of the trial court [R. 1385-1387] which for more than six weeks heard the evidence in this case; none of which is before this court.

We submit that Mr. Cochran has failed to make out a case for reversal.

CONCLUSION.

Many of the points urged by petitioners are founded upon a misconception of the record. Their contention that their contract rights have been impaired and that they have been denied due process is found on analysis to be untenable. We trust we have demonstrated to the satisfaction of this court that the approved plan was the only feasible plan which would preserve great benefits to all of the policyholders and make possible full restoration of rights; that the different treatment given certain policyholders was necessary by the very nature of the circumstances; that the plan was equitably and fairly conceived and that it was authorized by the principles found in decisions of this and other jurisdictions.

We are of the belief that, in a final analysis, the Commissioner had but two options: liquidation (immediate or deferred) or a plan embodying the principles of the approved plan. As a trustee he refused to follow the easier path, but, instead, meticulously worked out a plan which the Superior Court, after hearing the evidence, declared was fair and equitable and did not unjustly discriminate between any classes of policyholders. The Superior Court approved the plan after a trial lasting six weeks, during which oral and documentary evidence was introduced [R. 1383], no part of which evidence was brought to the California Supreme Court or to this court.

We respectfully submit that no constitutional rights of the petitioners have been violated and that the order of the Superior Court and the judgment of the Supreme Court of California were correct and should be affirmed.

Respectfully submitted,

T. B. COSGROVE,
JOHN N. CRAMER,
Counsel for Respondents Carroll C. Day, Harry C. Fabling, Joseph M. Gantz, Jack Paschall and Ralph J. Wetzel.

APPENDIX.

CODE OF CIVIL PROCEDURE, Section 416:

Sec. 416. From the time of the service of the summons and of a copy of the complaint in a civil action, or of the completion of the publication when service by publication is ordered, the court is deemed to have acquired jurisdiction of the parties, and to have control of all the subsequent proceedings. In all cases where a corporation has forfeited its charter or right to do business in this State, the persons who become the trustees of the corporation and of its stockholders or members may be sued in the corporate name of such corporation in like manner as if no forfeiture had occurred and from the time of service of the summons and of a copy of the complaint in a civil action, upon one of said trustees, or of the completion of the publication when service by publication is ordered, the court is deemed to have acquired jurisdiction of all said trustees, and to have control of all the subsequent proceedings. The voluntary appearance of a defendant is equivalent to personal service of the summons and copy of the complaint upon him.

CIVIL CODE OF CALIFORNIA, Sections 2252, 3537:

Sec. 2252. When a trustee is appointed by a court or public officer, as such, such court or officer is the trustor, within the meaning of the last section.

Sec. 3537. Superfluity does not vitiate.

CALIFORNIA INSURANCE CODE (1935), Sections 1011, 1012, 1013, 1015, 1019, 1043 and 1057:

Sec. 1011. Upon the filing, by the commissioner, with the superior court in the county in which is located the principal office of such person in this State, of a verified application showing any of the following conditions to exist:

(a) That such person has refused to submit its books, papers, accounts, or affairs to the reasonable inspection of the commissioner or his deputy or examiner.

(b) That such person has neglected or refused to observe an order of the commissioner to make good within the time prescribed by law any deficiency in its capital if it is a stock corporation, or in its reserve if it is a mutual insurer.

(c) That such person, without first obtaining the consent in writing of the commissioner, has transferred, or attempted to transfer, substantially its entire property or business or, without such consent, has entered into any transaction the effect of which is to merge, consolidate, or reinsure substantially its entire property or business in or with the property or business of any other person.

(d) That such person is found, after an examination, to be in such condition that its further transaction of business will be hazardous to its policy holders, or creditors, or to the public.

(e) That such person has violated its charter or any law of the State.

(f) That a certificate of authority of such person has been revoked under section 10711.

(g) That any officer of such person refuses to be examined under oath, touching its affairs.

(h) That any officer or attorney-in-fact of such person has embezzled, sequestered, or wrongfully diverted any of the assets of such person.

(i) That a domestic insurer does not comply with the requirements for the issuance to it of a certificate of authority, or that its certificate of authority has been revoked;

Or, upon the filing, by the commissioner, of a verified application accompanied by a certified copy of the commissioner's last report of examination of any person to whom the provisions of this article apply showing such person to be insolvent within the meaning of Article 13, Chapter 1, Part 2, Division 1 of this code, said court shall issue its order vesting title to all of the assets of said person, wheresoever situated, in the commissioner or his successors in office, in his official capacity as such, and directing the commissioner forthwith to take possession of all of its books, records, property, real and personal, and assets, and to conduct, as conservator, the business of said person, or so much thereof as to the commissioner may seem apropriate, and enjoining said person and its officers, directors, agents, servants and employees from the transaction of its business or disposition of its property until a further order of said court.

Sec. 1012. Said order shall continue in force and effect until, on the application either of the commissioner or of such person, it shall, after a full hearing, appear to said court that the ground for said order directing the commissioner to take title and possession does not exist or has been removed and that said person can properly resume title and possession of its property and the conduct of its business.

Sec. 1013. Whenever it appears to the commissioner that any of the conditions set forth in section 1011 exist or that irreparable loss and injury to the property and business of a person specified in section 1010 has occurred or may occur unless the commissioner so act immediately, the commissioner, without notice and before applying to the court for any order, forthwith shall take possession of the property, business, books, records and accounts of such person, and of the offices and premises occupied by it for the transaction of its business, and retain possession subject to the order of the court. Any person having possession of and refusing to deliver any of the books, records or assets of a person against whom a seizure order has been issued by the commissioner, shall be guilty of a misdemeanor and punishable by fine not exceeding one thousand dollars or imprisonment not exceeding one year, or both such fine and imprisonment.

Sec. 1015. Immediately after such seizure, the commissioner shall institute a proceeding as provided for in section 1011 and thereafter shall proceed in accordance with the provisions of this article.

Sec. 1016. If at any time after the issuance of an order under section 1011 it shall appear to the commissioner that further efforts to proceed under said section would be futile, he may apply to the court for an order to liquidate

and wind up the business of said person. Upon a full hearing of such application, the court may make an order directing the winding up and liquidation of the business of such person by the commissioner, as liquidator. The title to all property and assets of such person, vested in the commissioner under section 1011, shall remain in the commissioner, as liquidator, for the purpose of carrying out the order to liquidate and wind up the business of such person.

Sec. 1019. Upon the issuance of an order of liquidation under section 1016, the rights and liabilities of any such person and of creditors, policyholders, shareholders and members, and all other persons interested in its assets shall, unless otherwise directed by the court, be fixed as of the date of the entry of the order in the office of the clerk of the county wherein the application was made.

Sec. 1043. In any proceeding under this article, the commissioner, as conservator or as liquidator, may, subject to the approval of said court, and subject to such liens as may be necessary mutualize or reinsure the business of such person, or enter into *rehabilitation agreements.* Such rehabilitation or reinsurance agreements shall provide that, subsequent to the date thereof and for such period of time as the commissioner may determine, no investment or reinvestment of the assets of the person rehabilitated or reinsured shall be made without first obtaining the written approval of the commissioner. * * *

Sec. 1057. In all proceedings under this article, the commissioner shall be deemed to be a trustee for the benefit of all creditors and other persons interested in the estate of the person against whom the proceedings are pending.